

MAGNACHIP SEMICONDUCTOR LLC  
Form 10-Q  
August 15, 2007  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

\_\_\_\_\_  
**FORM 10-Q**  
\_\_\_\_\_

(Mark one)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the quarterly period ended July 1, 2007

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 333-126019-09

\_\_\_\_\_  
**MAGNACHIP SEMICONDUCTOR LLC**

(Exact name of Registrant as specified in its charter)

\_\_\_\_\_

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

**83-0406195**  
(I.R.S. Employer  
Identification No.)

c/o MagnaChip Semiconductor S.A.

74, rue de Merl, B.P. 709, L-2017

**Luxembourg, Grand Duchy of Luxembourg**  
(Address of principal executive offices)

**Not Applicable**  
(Zip Code)

Registrant's telephone number, including area code: (352) 45-62-62

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

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of August 1, 2007, the registrant had 52,800,784.0470 of the registrant's common units outstanding.

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MagnaChip Semiconductor LLC and Subsidiaries

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****MagnaChip Semiconductor LLC and Subsidiaries****Condensed Consolidated Statements of Operations****(Unaudited; in thousands of US dollars, except unit data)**

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>July 1, 2007</b>	<b>July 2, 2006</b>	<b>July 1, 2007</b>	<b>July 2, 2006</b>
Net sales	\$ 194,053	\$ 197,613	\$ 345,836	\$ 410,756
Cost of sales	166,299	177,342	303,159	350,157
Gross profit	27,754	20,271	42,677	60,599
Selling, general and administrative expenses	25,531	22,025	48,260	43,556
Research and development expenses	32,534	33,934	67,652	63,852
Restructuring and impairment charges	12,084	93,684	12,084	93,684
Operating loss	(42,395)	(129,372)	(85,319)	(140,493)
Other income (expenses)				
Interest expense, net	(14,952)	(14,352)	(29,368)	(29,085)
Foreign currency gain (loss), net	13,868	14,520	6,477	38,757
Loss before income taxes	(43,479)	(129,204)	(108,210)	(130,821)
Income tax expenses (benefits)	1,845	2,859	4,096	5,133
Net loss	\$ (45,324)	\$ (132,063)	\$ (112,306)	\$ (135,954)
Dividends accrued on preferred units	2,983	2,706	5,853	5,339
Net loss attributable to common units	\$ (48,307)	\$ (134,769)	\$ (118,159)	\$ (141,293)
Net loss per common units				
- Basic and diluted	\$ (0.92)	\$ (2.54)	\$ (2.24)	\$ (2.66)
Weighted average number of units				
- Basic and diluted	52,772,652	53,098,537	52,746,718	53,101,546

*The accompanying notes are an integral part of these financial statements*

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Condensed Consolidated Balance Sheets****(Unaudited; in thousands of US dollars, except unit data)**

	July 1, 2007	December 31, 2006
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 54,734	\$ 89,173
Accounts receivable, net	117,212	76,665
Inventories, net	71,723	57,846
Other receivables	7,178	6,754
Other current assets	19,646	13,626
Total current assets	270,493	244,064
Property, plant and equipment, net	278,529	336,279
Intangible assets, net	123,495	139,729
Other non-current assets	49,328	49,981
Total assets	\$ 721,845	\$ 770,053
<b>Liabilities and Unitholders Equity</b>		
Current liabilities		
Accounts payable	\$ 80,629	\$ 62,399
Other accounts payable	33,474	32,423
Accrued expenses	24,167	23,647
Short-term borrowings	40,000	
Other current liabilities	3,259	2,980
Total current liabilities	181,529	121,449
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	68,453	62,836
Other non-current liabilities	7,198	2,935
Total liabilities	1,007,180	937,220
Commitments and contingencies		
Series A redeemable convertible preferred units; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at July 1, 2007 and December 31, 2006		
Series B redeemable convertible preferred units; 550,000 units authorized, 450,692 units issued and 93,997 units outstanding at July 1, 2007 and December 31, 2006	123,227	117,374
Total redeemable convertible preferred units	123,227	117,374
Unitholders equity		
Common units; 65,000,000 units authorized, 52,800,784 and 52,720,784 units issued and outstanding at July 1, 2007 and December 31, 2006, respectively		
Additional paid-in capital	52,801	52,721
Accumulated deficit	2,521	2,451
Accumulated other comprehensive income	(490,027)	(370,314)
	26,143	30,601

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Total unitholders' equity	(408,562)	(284,541)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ 721,845	\$ 770,053

*The accompanying notes are an integral part of these financial statements*

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Condensed Consolidated Statements of Changes in Unitholders' Equity**

(In thousands of US dollars, except unit data)

	Common Units		Additional	Accumulated	Accumulated	Total
	Units	Amount	Paid-In Capital			
<b>Three months ended July 2, 2006</b>						
<b>Balance at April 2, 2006</b>	53,130,445	\$ 53,130	\$ 2,279	\$ (136,616)	\$ 34,263	\$ (46,944)
Exercise of unit options	2,812	3	5			8
Repurchase of units issued	(412,473)	(412)	(1)			(413)
Unit-based compensation			28			28
Dividends accrued on preferred units				(2,706)		(2,706)
Comprehensive income:						
Net loss				(132,063)		(132,063)
Fair valuation of derivatives					1,140	1,140
Foreign currency translation adjustments					1,143	1,143
<b>Total comprehensive income</b>						<b>(129,780)</b>
<b>Balance at July 2, 2006</b>	<b>52,720,784</b>	<b>\$ 52,721</b>	<b>\$ 2,311</b>	<b>\$ (271,385)</b>	<b>\$ 36,546</b>	<b>\$ (179,807)</b>
<b>Six months ended July 2, 2006</b>						
<b>Balance at January 1, 2006</b>	53,091,570	\$ 53,092	\$ 2,169	\$ (130,092)	\$ 28,347	\$ (46,484)
Exercise of unit options	41,687	41	41			82
Repurchase of units issued	(412,473)	(412)	(1)			(413)
Unit-based compensation			102			102
Dividends accrued on preferred units				(5,339)		(5,339)
Comprehensive income:						
Net loss				(135,954)		(135,954)
Fair valuation of derivatives					3,309	3,309
Foreign currency translation adjustments					4,890	4,890
<b>Total comprehensive income</b>						<b>(127,755)</b>
<b>Balance at July 2, 2006</b>	<b>52,720,784</b>	<b>\$ 52,721</b>	<b>\$ 2,311</b>	<b>\$ (271,385)</b>	<b>\$ 36,546</b>	<b>\$ (179,807)</b>

*The accompanying notes are an integral part of these financial statements*

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Condensed Consolidated Statements of Changes in Unitholders' Equity**

(In thousands of US dollars, except unit data)

	Common Units		Additional	Accumulated	Accumulated	Total
	Units	Amount	Paid-In			
			Capital		Comprehensive	
					Income	
<b>Three months ended July 1, 2007</b>						
<b>Balance at April 1, 2007</b>	52,720,784	\$ 52,721	\$ 2,476	\$ (441,720)	\$ 31,538	\$ (354,985)
Exercise of unit options	80,000	80				80
Unit-based compensation			45			45
Dividends accrued on preferred units				(2,983)		(2,983)
Comprehensive income (loss):						
Net loss				(45,324)		(45,324)
Fair valuation of derivatives					(17)	(17)
Foreign currency translation adjustments					(5,378)	(5,378)
Total comprehensive loss						(50,719)
<b>Balance at July 1, 2007</b>	52,800,784	\$ 52,801	\$ 2,521	\$ (490,027)	\$ 26,143	\$ (408,562)
<b>Six months ended July 1, 2007</b>						
<b>Balance at January 1, 2007</b>	52,720,784	\$ 52,721	\$ 2,451	\$ (370,314)	\$ 30,601	\$ (284,541)
Exercise of unit options	80,000	80				80
Unit-based compensation			70			70
Dividends accrued on preferred units				(5,853)		(5,853)
Retained earnings carried over from prior year (FIN 48)				(1,554)		(1,554)
Comprehensive income (loss):						
Net loss				(112,306)		(112,306)
Fair valuation of derivatives					(934)	(934)
Foreign currency translation adjustments					(3,524)	(3,524)
Total comprehensive loss						(116,764)
<b>Balance at July 1, 2007</b>	52,800,784	\$ 52,801	\$ 2,521	\$ (490,027)	\$ 26,143	\$ (408,562)

*The accompanying notes are an integral part of these financial statements*



**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Condensed Consolidated Statements of Cash Flows****(Unaudited; in thousands of US dollars)**

	<b>Six months ended</b>	
	<b>July 1, 2007</b>	<b>July 2, 2006</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (112,306)	\$ (135,954)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	89,974	102,509
Provision for severance benefits	9,379	5,357
Amortization of debt issuance costs	1,929	1,833
(Gain) loss on foreign currency translation, net	(6,326)	(42,367)
Impairment charges	10,106	92,540
Other	110	465
Changes in operating assets and liabilities		
Accounts receivable	(40,442)	25,007
Inventories	(13,237)	31,539
Other receivables	(411)	3,114
Accounts payable	18,857	(47,177)
Other accounts payable	(8,135)	(15,996)
Accrued expenses	392	(2,088)
Other current assets	3,430	(821)
Other current liabilities	347	(5,570)
Payment of severance benefits	(4,402)	(4,559)
Other	768	2,637
<b>Net cash provided by (used in) operating activities</b>	<b>(49,967)</b>	<b>10,469</b>
<b>Cash flows from investing activities</b>		
Purchase of plant, property and equipment	(24,399)	(19,332)
Purchase of intangible assets	(561)	(1,178)
Proceeds from disposal of plant, property and equipment	322	2,202
Proceeds from disposal of intangible assets		2,794
Decrease in restricted cash		1,876
Other	512	(927)
<b>Net cash used in investing activities</b>	<b>(24,126)</b>	<b>(14,565)</b>
<b>Cash flows from financing activities</b>		
Exercise of unit options	80	82
Repurchase of common units		(414)
Proceeds from short-term borrowings	40,000	
<b>Net cash provided by financing activities</b>	<b>40,080</b>	<b>(332)</b>
Effect of exchange rates on cash and cash equivalents	(426)	4,342
<b>Net increase (decrease) in cash and cash equivalents</b>	<b>(34,439)</b>	<b>(86)</b>
<b>Cash and cash equivalents</b>		
Beginning of the period	89,173	86,574

End of the period	\$ 54,734	\$ 86,488
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*The accompanying notes are an integral part of these financial statements*

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**MagnaChip Semiconductor LLC and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited; tabular dollars in thousands, except unit data)**

**1. Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited interim condensed consolidated financial statements of MagnaChip Semiconductor LLC and its subsidiaries (the Company) have been prepared in accordance with Accounting Principle Board (APB) Opinion No. 28, *Interim Financial Reporting* regarding interim financial information and, accordingly, do not include all of the information and note disclosures required by generally accepted accounting principles in the United States of America for complete financial statements. In the opinion of the Company's management, the unaudited interim condensed consolidated financial statements include all normal recurring adjustments necessary to fairly present the information required to be set forth therein. All inter-company accounts and transactions have been eliminated. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2006, which was filed with the SEC on March 30, 2007. The results of operations for the six-month period ended July 1, 2007 are not necessarily indicative of the results to be expected for a full year or for any other periods.

***Recent accounting pronouncements***

In February 2007, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption may have on its consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy, as defined and may be required to provide additional disclosures based on that hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption may have on its consolidated financial statements.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****2. Inventories**

Inventories as of July 1, 2007 and December 31, 2006 consist of the following:

	<b>July 1, 2007</b>	<b>December 31, 2006</b>
Finished goods	\$ 9,160	\$ 16,169
Semi-finished goods and work-in-process	60,327	39,492
Raw materials	11,127	11,774
Materials in-transit	810	2,063
Less: valuation allowances	(9,701)	(11,652)
Inventories, net	\$ 71,723	\$ 57,846

**3. Property, Plant and Equipment**

Property, plant and equipment as of July 1, 2007 and December 31, 2006 comprise the following:

	<b>July 1, 2007</b>	<b>December 31, 2006</b>
Buildings and related structures	\$ 153,110	\$ 162,383
Machinery and equipment	383,696	369,683
Vehicles and others	50,263	42,772
	587,069	574,838
Less: accumulated depreciation	(321,121)	(252,814)
Land	12,581	12,481
Construction in-progress		1,774
Property, plant and equipment, net	\$ 278,529	\$ 336,279

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****4. Intangible Assets**

Intangible assets as of July 1, 2007 and December 31, 2006 are as follows:

	July 1, 2007	December 31, 2006
Technology	\$ 21,460	\$ 21,289
Customer relationships	171,286	170,209
Goodwill	15,095	15,095
Intellectual property assets	9,553	9,742
Less: accumulated amortization	(93,899)	(76,606)
Intangible assets, net	\$ 123,495	\$ 139,729

**5. Product Warranties**

The Company records, in other current liabilities, warranty liabilities for the estimated costs that may be incurred under its basic limited warranty. This warranty covers defective products, and related liabilities are accrued when product revenues are recognized. Factors that affect the Company's warranty liability include historical and anticipated rates of warranty claims and repair costs per claim to satisfy the Company's warranty obligation. As these factors are impacted by actual experience and future expectations, the Company periodically assesses the adequacy of its recorded warranty liabilities and adjusts the amounts when necessary.

Changes in accrued warranty liabilities are as follows:

	Three months ended		Six months ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Beginning balance	\$ 87	\$ 1,027	\$ 112	\$ 1,036
Addition to (reversal of) warranty reserve	251	(693)	306	(575)
Payments made	(162)	(140)	(241)	(308)
Translation adjustments	4	13	3	54
Ending balance	\$ 180	\$ 207	\$ 180	\$ 207

**6. Short-term borrowings**

On December 23, 2004, the Company and its subsidiaries, including MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, entered into a senior credit agreement with a syndicate of banks, financial institutions and other entities providing for a \$100 million senior secured revolving credit facility. Interest is charged at current rates when drawn upon.

Under the senior secured revolving credit facility, among other things, on the last day of each fiscal month, the Company is required to maintain the sum of (A) the unutilized and available revolving commitments and (B) the qualified and unrestricted cash and cash equivalents held by the borrowers and the guarantors to be not less than \$ 75,000,000 ( Liquidity Requirement ). Presently, borrowings under the credit agreement bear interest equal to the 3-month LIBOR plus 4.75% or Alternate Base Rate ( ABR ) plus 3.75%. Additionally, the Company is required to pay the administrative agent for the account of each lender a commitment fee equal to 0.5% on the average daily unused amount of the commitment of

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each Lender during the period from December 23, 2004 to but excluding the date on which such commitments terminate. At July 1, 2007, the Company had borrowed \$40.0 million under this credit agreement.

Borrowings under the senior secured credit facility are subject to significant conditions, including compliance with financial ratios and other covenants and obligations.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)**

On June 28, 2007, the Company entered into the Seventh Amendment to Credit Agreement, dated as of June 28, 2007 (the Seventh Amendment), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto, and UBS AG, Stamford Branch, as administrative agent and collateral agent. Under the Seventh Amendment, among other things, the use of proceeds provision under Section 3.12 of the Credit Agreement was revised to provide increased flexibility for MagnaChip Semiconductor S.A. to use proceeds of any borrowing under the Credit Agreement.

Details of short-term borrowings as of July 1, 2007 are presented as below:

	<b>Maturity</b>	<b>Annual interest rate (%)</b>	<b>Amount of principal</b>
Euro dollar Revolving Loan	2007-09-21	3 month LIBOR + 4.75	\$ 7,000
Euro dollar Revolving Loan	2007-09-24	3 month LIBOR + 4.75	13,000
ABR Revolving Loan	2007-07-03	ABR + 3.75	20,000
			\$ 40,000

Subsequent to quarter end, on July 3, 2007, we repaid the ABR Revolving Loan in the amount of \$20 million from cash on hand.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****7. Long-term Borrowings**

On December 23, 2004, two of the Company's subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company issued \$500 million aggregate principal amount of Second Priority Senior Secured Notes consisting of \$300 million aggregate principal amount of Floating Rate Second Priority Senior Secured Notes and \$200 million aggregate principal amount of 6<sup>7</sup>/<sub>8</sub>% Second Priority Senior Secured Notes. At the same time, such subsidiaries issued \$250 million aggregate principal amount of 8% Senior Subordinated Notes.

Details of long-term borrowings as of July 1, 2007 and December 31, 2006 are presented as below:

	<b>Maturity</b>	<b>Annual interest rate (%)</b>	<b>Amount of principal</b>
Floating Rate Second Priority Senior Secured Notes	2011	3 month LIBOR + 3.250	\$ 300,000
6 <sup>7</sup> / <sub>8</sub> % Second Priority Senior Secured Notes	2011	6.875	200,000
8% Senior Subordinated Notes	2014	8.000	250,000
			\$ 750,000

The senior secured revolving credit facility and Second Priority Senior Secured Notes are collateralized by substantially all of the assets of the Company. The notes will be paid in full upon maturity.

Each indenture governing the notes contains covenants that limit the ability of the Company and its subsidiaries to (i) incur additional indebtedness, (ii) pay dividends or make other distributions on its capital stock or repurchase, repay or redeem its capital stock, (iii) make certain investments, (iv) incur liens, (v) enter into certain types of transactions with affiliates, (vi) create restrictions on the payment of dividends or other amounts to the Company by its subsidiaries, and (vii) sell all or substantially all of its assets or merge with or into other companies.

As of July 1, 2007, the Company and all of its subsidiaries except for MagnaChip Semiconductor (Shanghai) Company Limited have jointly and severally guaranteed each series of the Second Priority Senior Secured Notes on a second priority senior secured basis. As of July 1, 2007, the Company and its subsidiaries except for MagnaChip Semiconductor Ltd. (Korea) and MagnaChip Semiconductor (Shanghai) Company Limited have jointly and severally guaranteed the Senior Subordinated Notes on an unsecured, senior subordinated basis. In addition, the Company and each of its current and future direct and indirect subsidiaries (subject to certain exceptions) will be guarantors of the Second Priority Senior Secured Notes and Senior Subordinated Notes.

**Interest Rate Swap**

Effective June 27, 2005, the Company entered into an interest rate swap agreement (the "Swap") that converted the variable interest rate of three-month London Inter-bank Offering Rate (LIBOR) plus 3.25% to a fixed interest rate of 7.34% on the Company's Floating Rate Second Priority Senior Secured Notes (the "Notes"). This Swap will be in effect until June 15, 2008.



**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)**

The Swap qualifies as an effective cash flow hedge under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. The Company is utilizing the hypothetical derivative method to measure the effectiveness by comparing the changes in value of the actual derivative versus the change in fair value of the hypothetical derivative. Under this methodology, the actual swap was effective when compared to the hypothetical hedge.

For the six-month period ended July 1, 2007, the Company recorded changes in the fair value of the Swap amounting to \$934 thousand, under other comprehensive income in the accompanying condensed consolidated financial statements. In addition, during the same period, the Company recognized interest income of \$1,901 thousand, which represents the differences between fixed and variable rates.

**8. Accrued Severance Benefits**

The majority of accrued severance benefits is for employees in the Company's Korean subsidiary. Pursuant to the Labor Standards Act of Korea, most employees and executive officers with one or more years of service are entitled to severance benefits upon the termination of their employment based on their length of service and rate of pay. As of July 1, 2007, 97% of all employees of the Company were eligible for severance benefits.

Changes in the carrying value of accrued severance benefits are as follows:

	Three months ended		Six months ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Beginning balance	\$ 65,101	\$ 59,249	\$ 64,642	\$ 56,967
Provisions	5,198	2,320	9,379	5,357
Severance payments	(1,438)	(1,701)	(4,402)	(4,559)
Effect of foreign currency translation and other	1,321	925	563	3,028
Ending balance	70,182	60,793	70,182	60,793
Less: Cumulative contributions to the National Pension Fund	(816)	(888)	(816)	(888)
Group Severance insurance plan	(913)	(947)	(913)	(947)
	\$ 68,453	\$ 58,958	\$ 68,453	\$ 58,958

The severance benefits are funded approximately 2.46% and 3.02% as of July 1, 2007 and July 2, 2006, respectively, through the Company's National Pension Fund and group severance insurance plan which will be used exclusively for payment of severance benefits to eligible employees. These amounts have been deducted from the accrued severance benefit balance.

In addition, the Company expects to pay the following future benefits to its employees upon their normal retirement age:

	Severance benefit
2008	\$
2009	71
2010	217

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2011	76
2012	152
2013 2017	5,110

The above amounts were determined based on the employees' current salary rates and the number of service years that will be accumulated upon their retirement dates. These amounts do not include amounts that might be paid to employees that will cease working with the Company before their normal retirement ages.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****9. Redeemable Convertible Preferred Units**

The Company issued 49,727 units as Series A redeemable convertible preferred units (the Series A ) and 447,420 units as Series B redeemable convertible preferred units (the Series B ) on September 23, 2004 and additionally issued 364 units of Series A and 3,272 units of Series B on November 30, 2004, respectively. All of Series A were redeemed by cash on December 27, 2004 and some of the Series B were redeemed by cash on December 15, 2004 and December 27, 2004.

Changes in Series B for the three and six months ended July 1, 2007 are as follows:

	Three months ended			
	July 1, 2007		July 2, 2006	
	Units	Amount	Units	Amount
Beginning of period	93,997	\$ 120,244	93,997	\$ 109,095
Accrual of preferred dividends		2,983		2,706
End of period	93,997	\$ 123,227	93,997	\$ 111,801

	Six months ended			
	July 1, 2007		July 2, 2006	
	Units	Amount	Units	Amount
Beginning of period	93,997	\$ 117,374	93,997	\$ 106,462
Accrual of preferred dividends		5,853		5,339
End of period	93,997	\$ 123,227	93,997	\$ 111,801

The Series B were issued to the original purchasers of the Company in 2004. Holders of Series B receive dividends which are cumulative, whether or not earned or declared by the board of directors. The cumulative cash dividends accrue at the rate of 10% per unit per annum on the Series B original issue price, compounded semi-annually.

**10. Earnings per Unit**

The following table illustrates the computation of basic and diluted loss per common unit for the three-month and six-month periods ended July 1, 2007 and July 2, 2006:

	Three months ended		Six months ended	
	July 1, 2007	July 2, 2006	July 1, 2007	July 2, 2006
Net loss	\$ (45,324)	\$ (132,063)	\$ (112,306)	\$ (135,954)
Dividends to preferred unitholders	2,983	2,706	5,853	5,339
Net loss attributable to common units	\$ (48,307)	\$ (134,769)	\$ (118,159)	\$ (141,293)

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Weighted-average common units outstanding	52,772,652	53,098,537	52,746,718	53,101,546
Basic and diluted loss per unit	\$ (0.92)	\$ (2.54)	\$ (2.24)	\$ (2.66)

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)**

The following outstanding redeemable convertible preferred units issued, options granted and warrants issued were excluded from the computation of diluted loss per unit as they would have an anti-dilutive effect on the calculation:

	<b>Six months ended</b>	
	<b>July 1, 2007</b>	<b>July 2, 2006</b>
Redeemable convertible preferred units	93,997	93,997
Options	4,725,871	5,107,886
Warrant		5,079,254

In connection with the acquisition of the Company's business from Hynix Semiconductor Inc. on October 6, 2004, the Company issued a warrant to Hynix which enabled Hynix to purchase 5,079,254 common units of the Company at an exercise price of \$1.00 per unit. This warrant expired unexercised in accordance with its terms on October 6, 2006.

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**MagnaChip Semiconductor LLC and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(Unaudited; tabular dollars in thousands, except unit data)**

**11. Restructuring and Impairment Charges**

***Assets impairment***

During the three months ended July 1, 2007, the Company recognized impairment charges of \$10,106 thousand under SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets* ( SFAS No. 144 ). The impairment charges were recorded related to the closure of one of the Company's 5-inch wafer fabrication facilities that has generated losses and no longer supported the Company's strategic technology roadmap. During the six months ended July 2, 2006, the Company recorded impairment charges of \$92,540 thousand under SFAS No. 144. The impairment charges were recorded against one of our fabrication facilities and certain related technology and customer-based intangible assets (the asset group ).

SFAS No. 144 requires the Company to evaluate the recoverability of certain long-lived assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. The net book value of the asset group before the impairment charges as of July 1, 2007 and July 2, 2006 were approximately \$10,228 and \$185,985 thousand, respectively.

The impairment charge was measured as an excess of the carrying value of the asset group over its fair value. The fair value of the asset group was estimated using a present value technique, where expected future cash flows from the use and eventual disposal of the asset group were discounted by an interest rate commensurate with the risk of the cash flows.

***Restructuring***

During the three months ended July 1, 2007, the Company recognized \$1,978 thousand of restructuring under SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS No. 146 ). The restructuring charges were related to the closure of the Company's 5-inch wafer fabrication facilities to be completed by the end of 2007. These charges consist of one-time termination benefits, transfer of machinery and other associated costs.

During the three months ended July 2, 2006, the Company recorded restructuring charges of \$1,144 thousand in accordance with SFAS No. 146. These charges were incurred in association with changes in the Company's management judgment.

**12. Uncertainty in Income Taxes**

The Company, including its subsidiaries files income tax returns in Korea, Japan, Taiwan, U.S. and various other jurisdictions. The Company is subject to income tax examinations by tax authorities of these jurisdictions for all years since the beginning of its operation in October 2004.

The Company adopted the provisions of FIN No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of SFAS No. 109, on January 1, 2007. As a result of the implementation of FIN No. 48, the Company recognized a \$ 1,554 thousand increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings. Total amount of unrecognized tax benefits as of the date of adoption was \$6,908 thousand and it related to temporary difference arising from timing of expensing certain inventories. There was no change in total amount of unrecognized tax benefits during the three months ended July 1, 2007.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax expenses. The Company recognized \$40 thousand and \$80 thousand of interest and penalties, respectively, for the three and six months ended July 1, 2007. Total interest and penalties accrued as of July 1, 2007 and as of the adoption date were \$622 thousand and \$581 thousand respectively.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****13. Segment Information**

The Company has determined, based on the nature of its operations and products offered to customers, that its reportable segments are Display Solutions, Imaging Solutions, and Semiconductor Manufacturing Services. The Display Solutions segment's primary products are flat panel display drivers and the Imaging Solutions segment's primary products are CMOS image sensors. The Semiconductor Manufacturing Service segment provides for wafer foundry services to clients. Net sales and gross profit for the All other category primarily relates to certain business activities that do not constitute operating or reportable segments.

The Company's chief operating decision maker (CODM) as defined by SFAS 131, *Disclosure about Segments of an Enterprise and Related Information*, allocates resources to and assesses the performance of each segment using information about its revenue and gross profit. The Company does not identify or allocate assets by segments, nor does the CODM evaluate operating segments using discrete asset information. In addition, the Company does not allocate operating expense, interest income or expense, other income or expense, or income tax to the segments. Management does not evaluate segments based on these criteria.

The following sets forth information relating to the reportable segments:

	<b>Three months ended</b>	
	<b>July 1, 2007</b>	<b>July 2, 2006</b>
<b>Net Sales</b>		
Display Solutions	\$ 85,113	\$ 73,292
Imaging Solutions	17,371	15,596
Semiconductor Manufacturing Services	75,086	97,023
All other	16,483	11,702
Total segment net sales	\$ 194,053	\$ 197,613
<b>Gross Profit (Loss)</b>		
Display Solutions	\$ 8,136	\$ 8,089
Imaging Solutions	1,272	(3,642)
Semiconductor Manufacturing Services	11,716	16,635
All other	6,630	(811)
Total segment gross profit	\$ 27,754	\$ 20,271
	<b>Six months ended</b>	
	<b>July 1, 2007</b>	<b>July 2, 2006</b>
<b>Net Sales</b>		
Display Solutions	\$ 143,983	\$ 159,060
Imaging Solutions	29,143	35,000
Semiconductor Manufacturing Services	132,841	196,398
All other	39,869	20,298
Total segment net sales	\$ 345,836	\$ 410,756

<b>Gross Profit (Loss)</b>		
Display Solutions	\$ 15,225	\$ 26,069
Imaging Solutions	(148)	(8,010)
Semiconductor Manufacturing Services	14,563	41,222
All other	13,037	1,318
 Total segment gross profit	 \$ 42,677	 \$ 60,599



**Table of Contents**

**MagnaChip Semiconductor LLC and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements (Continued)**

**(Unaudited; tabular dollars in thousands, except unit data)**

**14. Condensed Consolidating Financial Statements**

The senior secured credit facility and Second Priority Senior Secured Notes are each fully and unconditionally guaranteed by the Company and all of its subsidiaries, except for MagnaChip Semiconductor (Shanghai) Company Limited. The Senior Subordinated Notes are fully and unconditionally guaranteed by the Company and all of its subsidiaries, except for MagnaChip Semiconductor, Ltd. (Korea) and MagnaChip Semiconductor (Shanghai) Company Limited. The Senior Subordinated Notes are structurally subordinated to the creditors of our principal manufacturing subsidiary, MagnaChip Semiconductor, Ltd. (Korea), which accounts for a majority of our net sales and substantially all of our assets.

Below are condensed consolidating balance sheets as of July 1, 2007 and December 31, 2006, condensed consolidating statements of operations for the three months and six months ended July 1, 2007 and July 2, 2006 and condensed consolidating statement of cash flows for the six months ended July 1, 2007 and July 2, 2006 of those entities that guarantee the Senior Subordinated Notes, those that do not, MagnaChip Semiconductor LLC, and the co-issuers.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Operations****For the three months ended July 1, 2007**

	MagnaChip Semiconductor LLC		Non-			
	(Parent)	Co-Issuers	Guarantors	Guarantors	Eliminations	Consolidated
Net sales	\$	\$	\$ 188,651	\$ 80,257	\$ (74,855)	\$ 194,053
Cost of sales			165,326	69,832	(68,859)	166,299
Gross profit			23,325	10,425	(5,996)	27,754
Selling, general and administrative expenses	189	229	21,905	3,271	(63)	25,531
Research and development expenses			32,778	5,641	(5,885)	32,534
Restructuring and impairment charge			12,084			12,084
Operating income (loss)	(189)	(229)	(43,442)	1,513	(48)	(42,395)
Other income (expenses)		(1,524)	(27)	467		(1,084)
Income (loss) before income taxes, equity in earnings (loss) of related equity investment	(189)	(1,753)	(43,469)	1,980	(48)	(43,479)
Income tax expenses		42	1	1,802		1,845
Loss before equity in loss of related investment	(189)	(1,795)	(43,470)	178	(48)	(45,324)
Loss of related investment	(45,135)	(43,557)		(43,079)	131,771	
Net loss	\$ (45,324)	\$ (45,352)	\$ (43,470)	\$ (42,901)	\$ 131,723	\$ (45,324)
Dividends accrued on preferred units	2,983					2,983
Net loss attributable to common units	\$ (48,307)	\$ (45,352)	\$ (43,470)	\$ (42,901)	\$ 131,723	\$ (48,307)

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Operations****For the six months ended July 1, 2007**

	MagnaChip Semiconductor LLC		Non-			
	(Parent)	Co-Issuers	Guarantors	Guarantors	Eliminations	Consolidated
Net sales	\$	\$	\$ 335,257	\$ 137,099	\$ (126,520)	\$ 345,836
Cost of sales			301,040	117,832	(115,713)	303,159
Gross profit			34,217	19,267	(10,807)	42,677
Selling, general and administrative expenses	245	561	40,707	6,683	64	48,260
Research and development expenses			68,076	10,225	(10,649)	67,652
Restructuring and impairment charge			12,084			12,084
Operating income (loss)	(245)	(561)	(86,650)	2,359	(222)	(85,319)
Other expenses		(2,630)	(20,015)	(246)		(22,891)
Income (loss) before income taxes, equity in earnings (loss) of related equity investment	(245)	(3,191)	(106,665)	2,113	(222)	(108,210)
Income tax expenses		85	34	3,977		4,096
Loss before equity in loss of related investment	(245)	(3,276)	(106,699)	(1,864)	(222)	(112,306)
Loss of related investment	(112,061)	(109,002)		(106,669)	327,732	
Net loss	\$ (112,306)	\$ (112,278)	\$ (106,699)	\$ (108,533)	\$ 327,510	\$ (112,306)
Dividends accrued on preferred units	5,853					5,853
Net loss attributable to common units	\$ (118,159)	\$ (112,278)	\$ (106,699)	\$ (108,533)	\$ 327,510	\$ (118,159)

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Operations****For the three months ended July 2, 2006**

	<b>MagnaChip Semiconductor LLC</b>						
	<b>(Parent)</b>	<b>Co-Issuers</b>	<b>Non-Guarantors</b>	<b>Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>	
Net sales	\$	\$	\$ 189,395	\$ 101,591	\$ (93,373)	\$ 197,613	
Cost of sales			174,434	93,489	(90,581)	177,342	
Gross profit			14,961	8,102	(2,792)	20,271	
Selling, general and administrative expenses	35	269	19,115	2,606		22,025	
Research and development expenses			34,003	3,573	(3,642)	33,934	
Restructuring and Impairment charges			93,459	225		93,684	
Operating income (loss)	(35)	(269)	(131,616)	1,698	850	(129,372)	
Other income (expenses)		6,106	2,058	(7,996)		168	
Income (loss) before income taxes, equity in loss of related equity investment	(35)	5,837	(129,558)	(6,298)	850	(129,204)	
Income tax expenses		41		2,818		2,859	
Income (loss) before equity in loss of related Investment	(35)	5,796	(129,558)	(9,116)	850	(132,063)	
Loss of related investment	(132,028)	(138,126)		(129,642)	399,796		
Net loss	\$ (132,063)	\$ (132,330)	\$ (129,558)	\$ (138,758)	\$ 400,646	\$ (132,063)	
Dividends accrued on preferred units	2,706					2,706	
Net loss attributable to common units	\$ (134,769)	\$ (132,330)	\$ (129,558)	\$ (138,758)	\$ 400,646	\$ (134,769)	

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Operations****For the six months ended July 2, 2006**

	<b>MagnaChip Semiconductor LLC</b>					
	<b>(Parent)</b>	<b>Co-Issuers</b>	<b>Non-Guarantors</b>	<b>Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$	\$ 397,823	\$ 200,385	\$ (187,452)	\$ 410,756
Cost of sales			346,877	185,853	(182,573)	350,157
Gross profit			50,946	14,532	(4,879)	60,599
Selling, general and administrative expenses	68	517	37,772	5,199		43,556
Research and development expenses			62,745	6,985	(5,878)	63,852
Restructuring and Impairment charges			93,459	225		93,684
Operating income (loss)	(68)	(517)	(143,030)	2,123	999	(140,493)
Other income (expenses)		10,421	13,268	(14,017)		9,672
Income (loss) before income taxes, equity in loss of related equity investment	(68)	9,904	(129,762)	(11,894)	999	(130,821)
Income tax expenses		82		5,051		5,133
Income (loss) before equity in loss of related Investment	(68)	9,822	(129,762)	(16,945)	999	(135,954)
Loss of related investment	(135,886)	(144,867)		(130,138)	410,891	
Net loss	\$ (135,954)	\$ (135,045)	\$ (129,762)	\$ (147,083)	\$ 411,890	\$ (135,954)
Dividends accrued on preferred units	5,339					5,339
Net loss attributable to common units	\$ (141,293)	\$ (135,045)	\$ (129,762)	\$ (147,083)	\$ 411,890	\$ (141,293)

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Balance Sheet****July 1, 2007**

	<b>MagnaChip Semiconductor LLC (Parent)</b>	<b>Co-Issuers</b>	<b>Non- Guarantors</b>	<b>Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$ 267	\$ 21,044	\$ 31,496	\$ 1,927	\$	\$ 54,734
Accounts receivable, net			120,070	54,161	(57,019)	117,212
Inventories, net			69,796	2,005	(78)	71,723
Other receivables		717	6,166	21,389	(21,094)	7,178
Short-term inter-company loans		20,000		20,000	(40,000)	
Other current assets	21	9,901	19,901	5,950	(16,127)	19,646
<b>Total current assets</b>	<b>288</b>	<b>51,662</b>	<b>247,429</b>	<b>105,432</b>	<b>(134,318)</b>	<b>270,493</b>
Property, plant and equipment, net						
Intangible assets, net			276,217	2,312		278,529
Investments in subsidiaries	(285,549)	(360,143)	102,759	20,922	(186)	123,495
Long-term inter-company loans		795,808		(189,009)	834,701	
Other non-current assets		18,972	42,372	9,419	(21,435)	49,328
<b>Total assets</b>	<b>(285,261)</b>	<b>506,299</b>	<b>668,777</b>	<b>582,603</b>	<b>(750,573)</b>	<b>721,845</b>
<b>Liabilities and Unitholders equity</b>						
Current liabilities						
Accounts payable	\$	\$	\$ 91,119	\$ 46,529	\$ (57,019)	\$ 80,629
Other accounts payable		6	50,293	4,269	(21,094)	33,474
Accrued expenses	74	3,234	22,502	11,262	(12,905)	24,167
S/T Borrowings		40,000	20,000	20,000	(40,000)	40,000
Other current liabilities		418	1,369	4,694	(3,222)	3,259
<b>Total current liabilities</b>	<b>74</b>	<b>43,658</b>	<b>185,283</b>	<b>86,754</b>	<b>(134,240)</b>	<b>181,529</b>
Long-term borrowings						
Accrued severance benefits, net		750,000	621,000	808,335	(1,429,335)	750,000
Other non-current liabilities			68,112	341	(21,435)	68,453
<b>Total liabilities</b>	<b>74</b>	<b>793,658</b>	<b>879,952</b>	<b>918,506</b>	<b>(1,585,010)</b>	<b>1,007,180</b>
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred units	123,227					123,227

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Total redeemable convertible preferred units	123,227					123,227
Unitholders' equity						
Common units	52,801	136,229	39,005	55,778	(231,012)	52,801
Additional paid-in capital	2,521	1,464	155,478	108,310	(265,252)	2,521
Accumulated deficit	(490,027)	(451,944)	(431,611)	(522,575)	1,406,130	(490,027)
Accumulated other comprehensive income	26,143	26,892	25,953	22,584	(75,429)	26,143
Total unitholders' equity	(408,562)	(287,359)	(211,175)	(335,903)	834,437	(408,562)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ (285,261)	\$ 506,299	\$ 668,777	\$ 582,603	\$ (750,573)	\$ 721,845

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Balance Sheet****December 31, 2006**

	MagnaChip Semiconductor LLC		Non-			
	(Parent)	Co-Issuers	Guarantors	Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$ 321	\$ 892	\$ 72,608	\$ 15,352	\$	\$ 89,173
Accounts receivable, net			86,488	34,971	(44,794)	76,665
Inventories, net			55,676	2,208	(38)	57,846
Other receivables		718	5,244	28,133	(27,341)	6,754
Other current assets	58	15,862	12,843	6,692	(21,829)	13,626
Total current assets	379	17,472	232,859	87,356	(94,002)	244,064
Property, plant and equipment, net						
Intangible assets, net			334,809	1,470		336,279
Investments in subsidiaries	(167,545)	(246,126)		(77,489)	491,160	
Long-term inter-company loans		791,648		633,987	(1,425,635)	
Other non-current assets		21,349	41,972	9,702	(23,042)	49,981
Total assets	\$ (167,166)	\$ 584,343	\$ 726,741	\$ 677,654	\$ (1,051,519)	\$ 770,053
<b>Liabilities and Unitholders equity</b>						
Current liabilities						
Accounts payable	\$	\$	\$ 67,002	\$ 40,191	\$ (44,794)	\$ 62,399
Other accounts payable		6	51,803	7,955	(27,341)	32,423
Accrued expenses	1	3,135	22,040	17,078	(18,607)	23,647
Other current liabilities		333	1,844	4,025	(3,222)	2,980
Total current liabilities	1	3,474	142,689	69,249	(93,964)	121,449
Long-term borrowings						
Accrued severance benefits, net		750,000	621,000	804,635	(1,425,635)	750,000
Other non-current liabilities			62,550	286		62,836
			1,191	24,786	(23,042)	2,935
Total liabilities	1	753,474	827,430	898,956	(1,542,641)	937,220
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred unites	117,374					117,374



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Total redeemable convertible preferred units	117,374					117,374
Unitholders' equity						
Common units	52,721	136,229	39,005	55,778	(231,012)	52,721
Additional paid-in capital	2,451	1,401	155,415	108,239	(265,055)	2,451
Accumulated deficit	(370,314)	(338,112)	(323,358)	(412,488)	1,073,958	(370,314)
Accumulated other comprehensive income	30,601	31,351	28,249	27,169	(86,769)	30,601
Total unitholders' equity	(284,541)	(169,131)	(100,689)	(221,302)	491,122	(284,541)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ (167,166)	\$ 584,343	\$ 726,741	\$ 677,654	\$ (1,051,519)	\$ 770,053

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Cash Flows****For the six months ended July 1, 2007**

	MagnaChip Semiconductor LLC		Non-			
	(Parent)	Co-Issuers	Guarantors	Guarantors	Eliminations	Consolidated
<b>Cash flow from operating activities:</b>						
Net loss	\$ (112,306)	\$ (112,278)	\$ (106,699)	\$ (108,533)	\$ 327,510	\$ (112,306)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			87,890	2,084		89,974
Provision for severance benefits			9,312	67		9,379
Amortization of debt issuance costs		1,443	486			1,929
(Gain) loss on foreign currency translation, net		(4,160)	(5,495)	3,329		(6,326)
Loss of related investment	112,061	109,002		106,669	(327,732)	
Impairment charges			10,106			10,106
Other			55	55		110
<b>Changes in operating assets and liabilities:</b>						
Accounts receivable			(33,036)	(19,630)	12,224	(40,442)
Inventories			(13,509)	233	39	(13,237)
Other receivables			(871)	6,707	(6,247)	(411)
Accounts payable			24,099	6,982	(12,224)	18,857
Other accounts payable			(10,740)	(3,642)	6,247	(8,135)
Accrued expenses	74	99	331	(5,814)	5,702	392
Other current assets	39	5,961	3,915	886	(7,371)	3,430
Other current liabilities		85	(480)	(660)	1,402	347
Payment of severance benefits			(4,402)			(4,402)
Other			640	829	(701)	768
Net cash provided by (used in) operating activities	(132)	152	(38,398)	(10,438)	(1,151)	(49,967)
<b>Cash flows from investing activities:</b>						
Purchase of plant, property and equipment			(23,176)	(1,223)		(24,399)
Payment for intellectual property registration			(721)	(34)	194	(561)
Proceeds from disposal of plant, property and equipment			314	8		322
Other		(20,000)	1,081	(20,569)	40,000	512
Net cash used in investing activities		(20,000)	(22,502)	(21,818)	40,194	(24,126)
<b>Cash flows from financing activities:</b>						
Exercise of unit options	80					80
Proceeds of short-term borrowings		40,000	20,000	20,000	(40,000)	40,000

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Net cash provided by financing activities	80	40,000	20,000	20,000	(40,000)	40,080
Effect of exchange rate on cash and cash equivalents	(2)		(212)	(1,169)	957	(426)
Net increase (decrease) in cash and cash equivalents	(54)	20,152	(41,112)	(13,425)		(34,439)
<b>Cash and cash equivalents:</b>						
Beginning of the period	321	892	72,608	15,352		89,173
End of the period	\$ 267	\$ 21,044	\$ 31,496	\$ 1,927	\$	\$ 54,734

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Cash Flows****For the six months ended July 2, 2006**

	<b>MagnaChip Semiconductor LLC</b>		<b>Non- Guarantors</b>		<b>Eliminations</b>	<b>Consolidated</b>
	<b>(Parent)</b>	<b>Co-Issuers</b>	<b>Guarantors</b>	<b>Guarantors</b>		
<b>Cash flow from operating activities:</b>						
Net loss	\$ (135,954)	\$ (135,045)	\$ (129,762)	\$ (147,083)	\$ 411,890	\$ (135,954)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			100,410	2,099		102,509
Provision for severance benefits			5,315	42		5,357
Amortization of debt issuance costs		1,384	449			1,833
Gain on foreign currency translation, net		(12,067)	(42,554)	12,254		(42,367)
Impairment charges			92,540			92,540
Loss of related investment	135,886	144,867		130,138	(410,891)	
Other			651	(1,802)	1,616	465
<b>Changes in operating assets and liabilities:</b>						
Accounts receivable			14,306	5,275	5,426	25,007
Inventories			30,250	2,247	(958)	31,539
Other receivables	434		2,689	(1,739)	1,730	3,114
Accounts payable			(43,676)	1,925	(5,426)	(47,177)
Other accounts payable	35	(435)	(14,954)	1,088	(1,730)	(15,996)
Accrued expenses		193	(412)	(2,596)	727	(2,088)
Other current assets		807	(676)	(225)	(727)	(821)
Other current liabilities		82	(1,852)	(3,800)		(5,570)
Payment of severance benefits			(4,559)			(4,559)
Other		(186)	5,462	(1,023)	(1,616)	2,637
Net cash provided by (used in) operating activities	401	(400)	13,627	(3,200)	41	10,469
<b>Cash flows from investing activities:</b>						
Purchase of plant, property and equipment			(18,890)	(442)		(19,332)
Purchase of intangible assets			(1,178)			(1,178)
Proceeds from disposal of plant, property and equipment			2,201	1		2,202
Proceeds from disposal of intangible assets			2,794			2,794
Decrease in restricted cash			1,876			1,876
Increase in short-term inter-company loans				(5,500)	5,500	
Other			(946)	19		(927)
Net cash used in investing activities			(14,143)	(5,922)	5,500	(14,565)

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**Cash flows from financing activities:**

Proceeds from short-term inter-company borrowings				5,500	(5,500)	
Exercise of unit options	82					82
Repurchase of common units	(414)					(414)
Net cash provided by (used in) financing activities	(332)			5,500	(5,500)	(332)
Effect of exchange rate on cash and cash equivalents			2,893	1,490	(41)	4,342
Net increase (decrease) in cash and cash equivalents	69	(400)	2,377	(2,132)		(86)

**Cash and cash equivalents:**

Beginning of the period	209	841	63,435	22,089		86,574
End of the period	\$ 278	\$ 441	\$ 65,812	\$ 19,957	\$	\$ 86,488

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**Table of Contents****PART I. Financial Information (continued)****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the federal securities laws that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors set forth elsewhere in this Form 10-Q and in prior Company public filings with the SEC. In addition, other factors have been or may be discussed from time to time in the Company's SEC filings. These forward-looking statements are made based on management's expectations and beliefs concerning future events impacting the Company and, therefore, involve a number of risks and uncertainties. The Company's management cautions that forward-looking statements are not guarantees and that actual results could differ materially from those expressed or implied in the forward-looking statements. The following discussion should be read in conjunction with the unaudited condensed consolidated interim financial statements and related notes included elsewhere in this Form 10-Q. While the Company periodically reassesses material trends and uncertainties affecting the Company's results of operations and financial condition in connection with the preparation of Management's Discussion and Analysis of Financial Condition and Results of Operations and certain other sections contained in the Company's quarterly, annual or other reports filed with the SEC, the Company does not intend to review or revise any particular forward-looking statement in light of future events.

**Overview**

We are a leading designer, developer and manufacturer of mixed-signal and digital multimedia semiconductors addressing the convergence of consumer electronics and communication devices. We focus our core business on CMOS image sensors and flat panel display drivers, which are complex, high-performance mixed-signal semiconductors that capture images and enable and enhance the features and capabilities of both small and large flat panel displays. We also provide wafer foundry services whereby we leverage our specialized process technologies and low cost manufacturing facilities to produce semiconductors for third parties using their product designs. Our solutions are used in a wide variety of consumer and commercial mass market applications, such as mobile handsets, including camera-equipped mobile handsets, flat panel monitors and televisions, mobile displays, portable computer displays, handheld gaming devices, PDAs and audio-visual equipment such as DVD players.

We have three separate business segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services.

*Display Solutions:* Our Display Solutions segment offers flat panel display drivers for the entire product range of small to large panel displays, including mobile handsets, handheld gaming devices, PDAs, displays for desktop and mobile computer monitors and flat panel televisions. Our products also cover a broad range of technologies and interfaces including LTPS, TFT, CSTN, OLED technologies, RSDS and mini-LVDS interfaces.

*Imaging Solutions:* Our Imaging Solutions segment address a broad spectrum of consumer electronics products ranging from camera-equipped mobile handsets to personal computer webcams, offering VGA, 1.3, 2.1 and 3.2 mega pixel CMOS image sensors. Our highly integrated image sensors are designed to be cost effective and to provide brighter, sharper and more colorful image quality for use primarily in applications that require small form factors, low power consumption, effective heat dissipation and high reliability.

*Semiconductor Manufacturing Services:* Our Semiconductor Manufacturing Services segment uses our process technology and manufacturing facilities to manufacture semiconductor wafers for third parties based on their designs. We provide our services to specialty markets that utilize high-voltage, embedded memory, analog and power processes. We offer customized services for clients globally at our state-of-the-art fabrication facilities located in Cheongju and Gumi, Korea. Our fabs provide us with large scale, cost-effective and flexible capacity enabling us to rapidly scale to high volume to meet shifts in demand by our end customers.

**Table of Contents****Results of Operations Comparison of Three-Month Periods Ended July 1, 2007 and July 2, 2006.**

The following table sets forth consolidated result of operations for the three months ended July 1, 2007 and July 2, 2006:

	Three months ended		Three months ended		Change	
	July 1, 2007		July 2, 2006			
	Amount	% of net sales	Amount	% of net sales	Amount	%
	<i>(in millions of US dollars; %)</i>					
Net sales	\$ 194.1	100.0	\$ 197.6	100.0	\$ (3.5)	(1.8)
Cost of sales	166.3	85.7	177.3	89.7	(11.0)	(6.2)
Gross profit	27.8	14.3	20.3	10.3	7.5	36.9
Selling, general and administrative expenses	25.6	13.2	22.0	11.1	3.6	16.4
Research and development expenses	32.5	16.7	33.9	17.2	(1.4)	(4.1)
Restructuring and impairment charges	12.1	6.2	93.7	47.4	(81.6)	(87.1)
Operating loss	(42.4)	(21.8)	(129.3)	(65.4)	86.9	(67.2)
Interest expense, net	(15.0)	(7.7)	(14.4)	(7.3)	(0.6)	4.2
Foreign currency gain, net	13.9	7.2	14.5	7.3	(0.6)	(4.1)
Loss before income taxes	(43.5)	(22.3)	(129.2)	(65.4)	85.7	(66.3)
Income tax expenses	1.8	0.9	2.9	1.5	(1.1)	(37.9)
Net loss	\$ (45.3)	(23.2)	\$ (132.1)	(66.9)	\$ 86.8	(65.7)

**Net Sales**

	Three months ended		Three months ended		Change	
	July 1, 2007		July 2, 2006			
	Amount	Total	Amount	total	Amount	%
	<i>(in millions of US dollars; %)</i>					
Display solutions	\$ 85.1	43.8	\$ 73.3	37.1	\$ 11.8	16.1
Imaging solutions	17.4	9.0	15.6	7.9	1.8	11.5
Semiconductor Manufacturing Services	75.1	38.7	97.0	49.1	(21.9)	(22.6)
All other	16.5	8.5	11.7	5.9	4.8	41.0
	\$ 194.1	100.0	\$ 197.6	100.0	\$ (3.5)	(1.8)

We derive a majority of our net sales from three operating segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. The All other category represents certain business activities other than these business segments, principally composed of rental and unit processing.

Total net sales for the three months ended July 1, 2007 decreased \$3.5 million, or 1.8% compared to the three months ended July 2, 2006. Net sales generated in the three operating segments during the most recently completed quarter were \$177.6 million, a decrease of \$8.3 million or 4.5% from the net sales of three operating segments for the prior-year quarter.

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*Display Solutions.* Net sales from Display Solutions for the three months ended July 1, 2007 were \$85.1 million, a \$11.8 million or 16.1% increase from \$73.3 million for the three months ended July 2, 2006. This sales increase in our display driver business was primarily attributable to higher volume driven from both current and the new products.

*Imaging Solutions.* Imaging Solutions net sales increased \$1.8 million in the most recently completed quarter, or 11.5% compared to net sales generated in the prior-year quarter. This sales increase in our imaging solution business was primarily attributable to an increase in small form factor VGA product sales and 1.3 mega pixel designs wins.

*Semiconductor Manufacturing Services.* Net sales from Semiconductor Manufacturing Services for the second quarter of 2007 were \$75.1 million, a \$21.9 million or 22.6% decrease compared to net sales of \$97.0 million for the prior-year quarter. This decrease was mainly due to decrease in end-market demand, coupled with continued average selling price erosion.

*All other.* Net sales from All other for the three months ended July 1, 2007 were \$16.5 million compared to \$11.7 million for the three months ended July 2, 2006.



**Table of Contents****Gross Profit**

	Three months ended July 1, 2007		Three months ended July 2, 2006		Change	
	Amount	net sales % of	Amount	net sales % of	Amount	%
	<i>(in millions of US dollars; %)</i>					
Display solutions	\$ 8.2	9.6	\$ 8.1	11.1	\$ 0.1	1.2
Imaging solutions	1.3	7.5	(3.6)	(23.1)	4.9	
Semiconductor Manufacturing Services	11.7	15.6	16.6	17.1	(4.9)	(29.5)
All other	6.6	40.0	(0.8)	(6.8)	7.4	
	\$ 27.8	14.3	\$ 20.3	10.3	\$ 7.5	36.9

Total gross profit increased \$7.5 million in the second quarter of 2007, or 36.9%, compared to the gross profit generated in the second quarter of 2006. Gross margin percentage for the most recently completed quarter was 14.3% of net sales, an increase of 4.0% from 10.3% for the prior-year quarter. This increase in gross margin percentage was mainly attributable to a volume increase in both unit processing and imaging solutions.

*Display Solutions.* Gross margin percentage for Display Solutions for the three months ended July 1, 2007 declined to 9.6% compared to 11.1% for the three months ended July 2, 2006. This decline in gross margin percentage was primarily attributable to average selling price erosion.

*Imaging Solutions.* Gross margin percentage for the most recently completed quarter was improved compared to the prior-year quarter mainly due to a decrease in depreciation cost resulting from impairment charges taken in the second quarter of 2006.

*Semiconductor Manufacturing Services.* Gross margin for Semiconductor Manufacturing Services declined to 15.6% in the second quarter of 2007 from 17.1% in the second quarter of 2006. A decrease in average selling price compared to the previous year's second quarter resulted in a decline of gross margin for the segment.

*All other.* Gross margin percentage for All other for current period increased to 40.0% from (6.8)% in the second quarter of 2006. This improvement in gross margin percentage is mainly due to the volume increase from unit processing, which resulted in lower fixed cost per unit.

**Operating Expenses**

*Selling, General and Administrative Expenses.* Selling, general, and administrative expenses were \$25.6 million or 13.2% of net sales for the three months ended July 1, 2007, compared to \$22.0 million or 11.1% for the three months ended July 2, 2006. The increase of \$3.6 million or 16.4% from the prior-year quarter was mainly attributable to employee related expenses such as salaries and benefits, and other expenses that included a special charge for a settlement with former subcontractors.

*Research and Development Expenses.* Research and development expenses for the most recently completed quarter were \$32.5 million, a decrease of \$1.4 million or 4.1% from \$33.9 million for the prior year quarter. As a percentage of net sales, research and development expenses for the most recently completed quarter decreased to 16.7% compared to 17.2% for the prior-year quarter.

*Restructuring and Impairment Charges.* During the second quarter ended July 1, 2007, we recognized restructuring and impairment charges of \$12.1 million which consisted of \$10.1 million of impairment under SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS No. 144 ) and \$2.0 million of restructuring under SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS No. 146 ). The impairment charges were recorded related to the closure of our 5-inch wafer fabrication facilities that has generated losses and no longer supported to our strategic technology roadmap.

During the three months ended July 2, 2006, we recorded restructuring and impairment charges totaling \$93.7 million, which included \$92.5 million of impairment under SFAS No. 144 and \$1.2 million of restructuring under SFAS No. 146. The impairment charges were recorded against one of our fabrication facilities and certain related technology and customer-based intangible assets and the restructuring charges were incurred in association with changes in certain of our management.



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***Net Interest Expense and Net Foreign Currency Gain or Loss***

*Net Interest Expense.* Net interest expense was \$15.0 million during the three-month period ended July 1, 2007, relatively consistent with \$14.4 million for the three-month period ended July 2, 2006. Substantially all of our interest expense is to service our long-term borrowings of \$750.0 million at a weighted-average interest rate of 7.4%. The increase in net interest expense was mainly due to a decrease in interest income from financial assets including cash and cash equivalents.

*Net Foreign Currency Gain or Loss.* Net foreign currency gain for the three months ended July 1, 2007 was \$13.9 million, compared to net foreign exchange gain of \$14.5 million for the three months ended July 2, 2006. A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss recorded for intercompany borrowings at our Korea subsidiary and is affected by changes in the exchange rate between Korea won and U.S. dollar.

***Income Tax Expenses***

*Income Tax Expenses.* Income tax expenses for the most recently completed quarter were \$1.8 million, compared to income tax expenses of \$2.9 million for the same quarter of 2006. Our income tax expenses are mostly composed of withholding taxes on inter-company interest payments and changes in deferred tax assets. Due to the uncertainty of utilization of foreign tax credits, we treated this withholding tax as a current tax expense.

**Table of Contents****Results of Operations Comparison of Six-Month Periods Ended July 1, 2007 and July 2, 2006.**

The following table sets forth consolidated result of operations for the six months ended July 1, 2007 and July 2, 2006:

	Six months ended		Six months ended		Change	
	July 1, 2007		July 2, 2006			
	Amount	% of net sales	Amount	% of net sales	Amount	%
	<i>(in millions of US dollars; %)</i>					
Net sales	\$ 345.8	100.0	\$ 410.8	100.0	\$ (65.0)	(15.8)
Cost of sales	303.1	87.7	350.2	85.2	(47.1)	(13.4)
Gross profit	42.7	12.3	60.6	14.8	(17.9)	(29.5)
Selling, general and administrative expenses	48.2	13.9	43.6	10.6	4.6	10.6
Research and development expenses	67.7	19.6	63.9	15.6	3.8	5.9
Restructuring and impairment charges	12.1	3.5	93.7	22.8	(81.6)	(87.1)
Operating loss	(85.3)	(24.7)	(140.6)	(34.2)	55.3	(39.3)
Interest expense, net	(29.4)	(8.5)	(29.1)	(7.1)	(0.3)	1.0
Foreign currency gain, net	6.5	1.9	38.8	9.4	(32.3)	(83.2)
Loss before income taxes	(108.2)	(31.3)	(130.9)	(31.9)	22.7	(17.3)
Income tax expenses	4.1	1.2	5.1	1.2	(1.0)	(19.6)
Net loss	\$ (112.3)	(32.5)	\$ (136.0)	(33.1)	\$ 23.7	(17.4)

**Net Sales**

	Six months ended		Six months ended		Change	
	July 1, 2007		July 2, 2006			
	Amount	% of Total	Amount	% of total	Amount	%
	<i>(in millions of US dollars; %)</i>					
Display solutions	\$ 144.0	41.6	\$ 159.1	38.7	\$ (15.1)	(9.5)
Imaging solutions	29.1	8.4	35.0	8.5	(5.9)	(16.9)
Semiconductor Manufacturing Services	132.8	38.4	196.4	47.8	(63.6)	(32.4)
All other	39.9	11.6	20.3	5.0	19.6	96.6
	\$ 345.8	100.0	\$ 410.8	100.0	\$ (65.0)	(15.8)

We derive a majority of our net sales from three operating segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. The All other category represents certain business activities other than these business segments, principally composed of rental and unit processing.

Total net sales for the six months ended July 1, 2007 decreased \$65.0 million, or 15.8% compared to the six months ended July 2, 2006. Net sales generated in the three operating segments during the current period were \$305.9 million, a decrease of \$84.6 million or 21.7% from the net sales of our three operating segments for the prior-year period.

*Display Solutions.* Net sales from Display Solutions for the six months ended July 1, 2007 were \$144.0 million, a \$15.1 million or 9.5% decrease from \$159.1 million for the six months ended July 2, 2006. This sales decrease was primarily attributable to a decline in average selling

price.

*Imaging Solutions.* Imaging Solutions net sales decreased \$5.9 million in the current period, or 16.9% compared to net sales generated in the prior-year period. This decrease was primarily attributable to the delays in transition to new mega-pixel products, which was expected to substitute our VGA products.

*Semiconductor Manufacturing Services.* Net sales from Semiconductor Manufacturing Services for the six months ended July 1, 2007, were \$132.8 million, a \$63.6 million or 32.4% decrease compared to net sales of \$196.4 million for the six months ended July 2, 2006. This decrease was mainly due to a decrease in end-market demand, coupled with continued average selling price erosion.

*All other.* Net sales from All other for the six months ended July 1, 2007 were \$39.9 million compared to \$20.3 million for the six months ended July 2, 2006. This increase of \$19.6 million substantially represents the revenue increase from our unit processing service.

**Table of Contents****Gross Profit**

	Six months ended July 1, 2007		Six months ended July 2, 2006		Change	
	% of		% of			
	Amount	net sales	Amount	net sales	Amount	%
	<i>(in millions of US dollars; %)</i>					
Display solutions	\$ 15.3	10.6	\$ 26.1	16.4	\$ (10.8)	(41.4)
Imaging solutions	(0.2)	(0.7)	(8.0)	(22.9)	7.8	(97.5)
Semiconductor Manufacturing Services	14.5	10.9	41.2	21.0	(26.7)	(64.8)
All other	13.1	32.8	1.3	6.4	11.8	907.7
	\$ 42.7	12.3	\$ 60.6	14.8	\$ (17.9)	(29.5)

Total gross profit decreased \$17.9 million in the six months ended July 1, 2007, or 29.5%, compared to the gross profit generated in the six months ended July 2, 2006. Gross margin percentage for the six months ended July 1, 2007 was 12.3% of net sales, a decrease of 2.5% from 14.8% for the six months ended July 2, 2006. This decline in gross margin percentage was primarily attributable to an overall decrease in average selling prices.

*Display Solutions.* Gross margin percentage for Display Solutions for the six months ended July 1, 2007 declined to 10.6% compared to 16.4% for the six months ended July 2, 2006. This decline in gross margin percentage was primarily attributable to lower average selling price.

*Imaging Solutions.* Gross margin percentage for the current period was improved compared to the prior period mainly due to a decrease in depreciation costs resulting from impairment charges taken in the second quarter of 2006.

*Semiconductor Manufacturing Services.* Gross margin for Semiconductor Manufacturing Services declined to 10.9% in the six months ended July 1, 2007 from 21.0% in the six months ended July 2, 2006. The year-over-year decrease was mainly due to a decrease in end-user market demand and a decline in average selling price.

*All other.* Gross margin percentage for All other for current period increased to 32.8% from 6.4% for the prior period. This improvement in gross margin percentage is mainly attributable to sales volume increase for unit processing.

**Operating Expenses**

*Selling, General and Administrative Expenses.* Selling, general, and administrative expenses were \$48.2 million or 13.9% of net sales for the six months ended July 1, 2007 compared to \$43.6 million or 10.6% for the six months ended July 2, 2006. The increase of \$4.6 million or 10.6% from the prior-year period was mainly attributable to employee related expenses, including other expenses such as the special charge for a settlement with former subcontractors, that was partially offset by decreases in depreciation and amortization expenses resulting from impairment charges taken during the second quarter of 2006.

*Research and Development Expenses.* Research and development expenses for the current period were \$67.7 million, an increase of \$3.8 million or 5.9% from \$63.9 million for the prior year period. This increase in research and development expenses essentially represented our focus on the introduction of new products, especially for the Imaging Solutions and Semiconductor Manufacturing Services segments. As a percentage of net sales, research and development expenses for the current period increased to 19.6% compared to 15.6% for the prior-year period.

*Restructuring and Impairment Charges.* During the second quarter ended July 1, 2007, we recognized restructuring and impairment charges of \$12.1 million which consisted of \$10.1 million of impairment under SFAS No. 144 and \$2.0 million of restructuring under SFAS No. 146. The impairment charges were recorded related to the closure of our 5-inch wafer fabrication facilities that has generated losses and no longer supported to our strategic technology roadmap.

During the six months ended July 2, 2006, we recorded restructuring and impairment charges totaling \$93.7 million, which included \$92.5 million of impairment under SFAS No. 144 and \$1.2 million of restructuring under SFAS No. 146. The impairment charges were recorded against one of our fabrication facilities and certain related technology and customer-based intangible assets and the restructuring charges were

incurred in association with changes in certain of our management.

***Net Interest Expense and Net Foreign Currency Gain or Loss***

*Net Interest Expense.* Net interest expense was \$29.4 million during the six months period ended July 1, 2007, relatively consistent with \$29.1 million for the six months ended July 2, 2006. Substantially all of our interest expense is to

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service our long-term borrowings of \$750.0 million at a weighted-average interest rate of 7.4%. The increase in net interest expense was mainly due to a decrease in interest income from financial assets including cash and cash equivalents.

*Net Foreign Currency Gain or Loss.* Net foreign currency gain for the six months ended July 1, 2007 was \$6.5 million, compared to net foreign exchange gain of \$38.8 million for the six months ended July 2, 2006. A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss recorded for intercompany borrowings at our Korea subsidiary and is affected by changes in the exchange rate between the Korea won and U.S. dollar.

### ***Income Tax Expenses***

*Income Tax Expenses.* Income tax expenses for the current period were \$4.1 million, compared to income tax expenses of \$5.1 million for the same period of 2006. Our income tax expenses are mostly composed of withholding taxes on inter-company interest payments and changes in deferred tax assets. Due to the uncertainty of the utilization of foreign tax credits, we treated this withholding tax as a current tax expense.

### **Liquidity and Capital Resources**

Our principal capital requirements are to fund working capital needs, to meet required debt payments, including debt service payments on the notes and the senior credit facility, and to invest in research and development and capital equipment. We anticipate that operating cash flow, together with available borrowing capacity under our senior credit facility, will be sufficient to meet our working capital needs, our research and development and capital expenditures needs and service requirements on our debt obligations for the foreseeable future. As of July 1, 2007, we had total outstanding long-term debt of \$750.0 million.

Our principal sources of liquidity are our cash, cash equivalents and available borrowings under our senior credit facility of \$100 million. As of July 1, 2007, our cash and cash equivalents balance was \$54.7 million or 7.6% of our total assets, a \$34.5 million decrease from \$89.2 million or 11.6% of total assets as of December 31, 2006. The decrease in cash and cash equivalents during the first half of 2007 was primarily attributable to cash outflow of \$50.0 million in operating activities, coupled with cash outflow related to six months capital expenditures of \$25.0 million.

During the six-month period ended July 1, 2007, net cash used in operating activities was \$50.0 million, compared to \$10.5 million of net cash generated by operating activities during the year-ago period. This decrease in cash from operating activities between the two periods was primarily attributable to a reduction in gross profit of \$17.9 million resulting mainly from lower revenue. The net operating cash outflow for the current period principally reflects our net loss of \$112.3 million adjusted by \$105.2 million which mostly consisted of costs related to depreciation, impairment and amortization charges and an increase in working capital of \$42.9 million.

Our working capital balance as of July 1, 2007 was \$89.0 million compared to \$122.6 million as of December 31, 2006. The decrease of \$33.6 million in our working capital balance was mainly due to a \$34.5 million reduction in cash and cash equivalents driven by the aforementioned reasons. This decrease in cash and cash equivalents was partially offset by inventory build-up of \$13.9 million representing expected sales growth in the coming periods.

For investing activities, net cash outlay during the six months ended July 1, 2007 was \$24.1 million, compared to \$14.6 million in the prior-year period. In the prior-year period, cash outlay for our capital expenditures was offset by a cash inflow from the sale of our application processor business.

*Capital Expenditures.* For the six months ended July 1, 2007, capital expenditures were \$25.0 million, a \$4.5 million or 22.0% increase from \$20.5 million for the six months ended July 2, 2006. We will continue to manage the timing of our capital expenditures to support the growth of business from new customers and to optimize return on our investment.

*Future Financing Activities.* Our primary future capital requirements on a recurring basis will be funding working capital needs, meeting required debt payments, funding research and development, and capital expenditures. We anticipate that operating cash flows, together with available borrowings under our senior credit facility, will be sufficient to meet these capital requirements for the foreseeable future. We may from time to time incur additional debt.

We may need to incur additional debt or issue equity to make strategic acquisitions of investments. However, we cannot assure you that such financing will be available to us on acceptable terms or that such financing will be available at all.





**Table of Contents****Contractual Obligations**

Summarized in the table below are our obligations and commitments to make future payments under debt obligations and minimum lease payment obligations as of July 1, 2007.

	Payments Due by Period							Interest expense
	Total	2007	2008	2009	2010	2011	Thereafter	
	<i>(in millions of US dollars)</i>							
Revolving credit facility(*)	40.0	40.0						
Secured notes and subordinated notes(*)	750.0					500.0	250.0	
Operating lease	61.7	5.7	11.2	11.2	11.2	11.2	11.2	
Others	15.2	6.5	5.0	3.8				(0.1)

(\*)Excludes interest obligations thereon.

The Floating Rate Second Priority Senior Secured Notes of \$300 million and Second Priority Senior Secured Notes of \$200 million mature in 2011, while the Senior Subordinated Notes of \$250 million mature in 2014. Interest rates are 3 month LIBOR + 3.25%, 6<sup>7</sup>/<sub>8</sub> % and 8%, respectively. These notes will be paid in full upon maturity.

Each indenture governing the notes contains covenants that limit the ability of the Company and its subsidiaries to (i) incur additional indebtedness, (ii) pay dividends or make other distributions on its capital stock or repurchase, repay or redeem its capital stock, (iii) make certain investments, (iv) incur liens, (v) enter into certain types of transactions with affiliates, (vi) create restrictions on the payment of dividends or other amounts to the Company by its subsidiaries, and (vii) sell all or substantially all of its assets or merge with or into other companies.

On June 28, 2007, the Company entered into the Seventh Amendment to Credit Agreement, dated as of June 28, 2007 (the Seventh Amendment), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto, and UBS AG, Stamford Branch, as administrative agent and collateral agent. Under the Seventh Amendment, among other things, the use of proceeds provision under Section 3.12 of the Credit Agreement was revised to provide increased flexibility for MagnaChip Semiconductor S.A. to use proceeds of any borrowing under the Credit Agreement.

The Company adopted the provision of FIN No.48, *Accounting for Uncertainty in Income Taxes* on January 1, 2007. As of the date of adoption, the Company's unrecognized tax benefits totaled \$1.6 million. These unrecognized tax benefits have been excluded from the above table because we cannot estimate the period of cash settlement with the respective taxing authorities.

**Off Balance Sheet Arrangements**

On December 23, 2004, two of the Company's subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company entered into a senior credit agreement with a syndicate of banks, financial institutions and other entities providing for a \$100 million senior secured revolving credit facility. The undrawn portion of such senior secured credit line as of July 1, 2007 and December 31, 2006 were \$45.2 million and \$93.8 million, respectively. The utilized portions of the credit line are related to the issuance of letters of credit and cash drawdowns.

Other than the senior credit facility, there are no material off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

**Recent accounting pronouncements**

In February 2007, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*, which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. We are currently evaluating the impact that the adoption may have on our consolidated financial statements.

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In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*. This Statement defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of its financial instruments according to a fair value hierarchy, as defined

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and may be required to provide additional disclosures based on that hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that the adoption may have on our consolidated financial statements.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires our management to make significant judgments and estimates that affect our financial position and results of operations.

#### ***Revenue Recognition***

Our revenue is derived from the sale of semiconductor products we design and the manufacture of semiconductor wafers for third parties. We recognize revenue when persuasive evidence of an arrangement exists, the product has been delivered and title and risk of loss have transferred, the price is fixed and determinable, and collection of resulting receivables is reasonably assured. For certain distributors, standard products are sold without rights to return products or stock rotation or price protection rights. Our policy is to recognize revenue upon delivery of products to customers, where shipment represents the point when the rights and risks of ownership have passed to the customer, when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. Specialty foundry services are performed pursuant to manufacturing agreements and purchase orders. Standard products are shipped and sold based upon purchase orders from customers. All amounts billed to a customer related to shipping and handling are classified as sales, while all costs incurred by us for shipping and handling are classified as expenses.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payment. If the financial condition of our customers were to deteriorate, additional allowances may be required. We record warranty liabilities for the estimated costs that may be incurred under our limited warranty. This warranty covers product defects based on compliance to our specifications and is normally applicable for twelve months from the date of purchase. These liabilities are recorded when related revenue is recognized. Warranty costs include the costs to replace the defective product. Factors that affect our warranty liability include the historical and anticipated rate of warranty claims on those repairs and the cost per claim to satisfy our warranty obligations. As these factors are impacted by actual experience and future expectations, we periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary.

#### ***Inventory Valuation***

Inventories are stated at the lower of cost or market, using the average cost method, which approximates the first in, first out method. If net realizable value is less than cost at the balance sheet date, the carrying amount is reduced to the realizable value, and the difference is recognized as a loss on valuation of inventories under cost of sales. We estimate the net realizable value for such finished goods and work-in-progress based on current invoice prices. Inventory reserves are established when conditions indicate that the net realizable value is less than cost due to physical deterioration, obsolescence, changes in price levels, or other causes. Reserves are also established for excess inventory based on inventory levels in excess of six months of projected demand, as judged by management, for each specific product.

In addition, as prescribed in SFAS No. 151, the cost of inventories is determined based on the normal capacity of each fabrication facility. In case the capacity utilization is lower than a certain level, that the management believes to be normal, the fixed overhead costs per production unit which exceeds those under normal capacity, are charged to cost of sales rather than capitalized as inventories.

#### ***Useful Lives of Tangible and Intangible Assets***

Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Buildings and related structures are depreciated over the 10 to 40 year periods. Machinery, equipment and other assets including vehicles are depreciated over the estimated useful lives ranging 5 to 10 years.

Our intangible assets represent rights under patents, trademarks, property use rights, customer relationship and technology, and are amortized over the periods of benefit, ranging up to 10 years, on a straight-line basis.

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**Table of Contents*****Impairment of Long-Lived Assets***

We review the carrying value of fixed assets for impairment when events and circumstances indicate that the carrying value of an asset or group of assets may not be recoverable from the estimated future cash flows expected to result from its use and/or disposition. Factors which could trigger an impairment review include the following: (i) significant negative industry or economic trends, (ii) exiting an activity in conjunction with a restructuring of operations, (iii) current, historical or projected losses that demonstrate continuing losses associated with an asset, and (iv) management's assessment of future manufacturing capacity requirements. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment charge is recognized equal to the amount by which the carrying value exceeds the estimated fair value of the assets. The estimation of future cash flows involves numerous assumptions, which require our judgment, including, but not limited to, future use of the assets for our operations versus sale or disposal of the assets, future-selling prices for our products and future production and sales volumes. In addition, we must use our judgment in determining the groups of assets for which impairment tests are separately performed.

***Restructuring Charges***

We recognize restructuring charges in accordance with SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. Certain costs and expenses related to exit or disposal activities are recorded as restructuring charges when liabilities for those costs and expenses are incurred.

***Income Taxes***

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in a company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities. We established valuation allowances for deferred tax assets at most of our subsidiaries since, other than with respect to one particular subsidiary, it is not probable that a majority of the deferred tax assets will be realizable. The valuation allowance at this particular subsidiary was not set up since it is expected that the deferred tax assets at this subsidiary will be deemed realizable based on the current prospects for its future taxable income.

In addition, beginning January 1, 2007, we account for uncertainties related to income taxes in compliance with FIN No. 48, *Accounting for Uncertainty in Income Taxes*—an interpretation of SFAS No. 109. Under FIN No. 48, we evaluate our tax positions taken or expected to be taken in a tax return for recognition and measurement on our financial statements. Only those tax positions that meet the more-likely-than-not threshold are recognized on the financial statements at the largest amount of benefit that is greater than 50 percent likely of ultimately being realized.

***Unit-based Compensation***

Pursuant to the provisions of SFAS No. 123(R), unit-based compensation cost is estimated at the grant date based on the fair-value of the award and is recognized as expense over the requisite service period of the award. We utilize the Black-Scholes option pricing model to value options. In developing assumptions for fair value calculation under SFAS No. 123(R), we use estimates based on historical data and market information. A small change in the assumptions used in the estimate can cause a relatively significant change in the fair value calculation.

The valuation of our common unit is based on an independent appraisal from a third party and is updated reflecting the changes in our financial results and prospects. Determination of the fair value of our common units involves complex and subjective judgments. If we make different judgments or adopt different assumptions, material differences could result in the timing and amount of the unit-based compensation expenses recorded because the estimated fair value of the underlying units for the options granted would be different.

***Segment Information***

We have determined, based on the nature of our operations and products offered to customers, that our reportable segments are Display Solutions, Imaging Solutions, and Semiconductor Manufacturing Services. Our chief operating decision maker ( CODM ) as defined by SFAS 131, *Disclosure about Segments of an Enterprise and Related Information*, allocates resources to and assesses the performance by these segments.



**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

Market risk is the risk that the value of a financial instrument will fluctuate due to changes in market conditions, including changes in interest rates and foreign exchange rates. In the normal course of our business, we are subject to market risk associated with interest rate movements and currency movements on our assets and liabilities.

*Foreign Currency Risk.* We have exposure to foreign currency exchange-rate fluctuations on net income from our subsidiaries denominated in currencies other than U.S. dollars, as our foreign subsidiaries in Korea, Taiwan, China, Japan and Hong Kong use local currency as their functional currency. From time to time these subsidiaries have cash and financial instruments in local currency. The amounts held in Japan, Taiwan, Hong Kong and China are not material in regards to foreign currency movements. However, based on the cash and financial instruments balance at July 1, 2007 for our Korean subsidiary, a 10% devaluation of the Korean Won against the U.S. dollar would have resulted in a decrease of \$1.6 million in our U.S. dollar financial instruments balance and cash balance.

*Interest Rate Risk.* The \$200 million 6<sup>7</sup>/<sub>8</sub>% Second Priority Senior Secured Notes due 2011 and the \$250 million 8% Senior Subordinated Notes due 2014 are subject to changes in fair value due to interest rate changes. If the market interest rate had decreased by 10% and all other variables were held constant from their levels at July 1, 2007, we estimate that we would have additional interest expense costs over the market rate of \$0.7 million for the three months ended July 1, 2007. The fair value of these fixed rate notes would have decreased by \$7.8 million or increased by \$8.1 million with a 10% increase or decrease in the interest rate, respectively.

*Cash Flow Interest Rate Risk.* In 2005, we entered into an interest rate swap agreement to convert the variable interest rate on our Floating Rate Second Priority Senior Secured Notes to a fixed interest rate for the periods to maturity date of June 2008. With this interest rate swap, cash flow interest rate risk was replaced with exposure to interest rate risk. For details, refer to Note 6. Long-term Borrowings.

**Item 4T. Controls and Procedures  
Disclosure Controls and Procedures**

As required by the Securities Exchange Act of 1934, as amended (the Exchange Act), our management, including our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. As defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures that we use that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our CEO and our CFO, as appropriate, to allow timely decisions regarding required disclosure.

Based upon that evaluation, our CEO and our CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

**Inherent Limitations on Effectiveness of Controls**

Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures 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, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. 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 controls effectiveness 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. Our internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of our financial reporting and preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements.





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### **Changes in Internal Control Over Financial Reporting**

There has been no change in our internal control over financial reporting during our most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

## **PART II OTHER INFORMATION**

### **Item 1A. Risk Factors**

#### **The cyclical nature of the semiconductor industry may limit our ability to maintain or increase net sales and profit levels during industry downturns.**

The semiconductor industry is highly cyclical and periodically experiences significant economic downturns characterized by diminished product demand, resulting in production overcapacity and excess inventory in the markets we serve, which can result in rapid erosion of average selling prices. The industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers' products and the decline in general economic conditions.

We have experienced these conditions in our business in the past and may experience renewed, and possibly more severe and prolonged, downturns in the future as a result of such cyclical changes. This may reduce our profitability and the value of our business.

#### **Customer demand is difficult to accurately forecast.**

We make significant decisions, including determining the levels of business that we will seek and accept, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of rapid changes in demand for their products reduces our ability to accurately estimate future customer demand. On occasion, customers may require rapid increases in production, which can challenge our resources and reduce margins. We may not have sufficient capacity at any given time to meet our customers' increased demand for our product. Conversely, downturns in the semiconductor industry may cause and have caused our customers to significantly reduce the amount of products ordered from us. Because many of our costs and operating expenses are relatively fixed, a reduction in customer demand may decrease our gross margins and operating income.

#### **Our customers may cancel their orders, change production quantities or delay production.**

We generally do not obtain firm, long-term purchase commitments from our customers. Customers may cancel their orders, change production quantities or delay production for a number of reasons. Cancellations, reductions or delays by a significant customer or by a group of customers, which we have experienced as a result of the recent downturn in the semiconductor industry, have adversely affected and may continue to adversely affect our results of operations. In addition, while we do not obtain long-term purchase commitments, we generally agree to the pricing of a particular product for the entire lifecycle of the product, which can extend over a number of years. If we underestimate our costs when determining the pricing, our margins and results of operations would be adversely affected.

#### **A significant portion of our sales comes from a relatively limited number of customers.**

If we were to lose key customers or if customers cease to place orders for our high volume devices, our financial results will be adversely affected. While we served more than 171 customers in the six-month period ended July 1, 2007, net sales to our 10 largest customers represented approximately 65.6% of our net sales for the period. We had one individual customer and one group of affiliated customers that each represented greater than 10% of our net sales during the six months ended July 1, 2007. Significant reductions in sales to any of these customers, the loss of major customers or the curtailment of orders for our high-volume devices within a short period of time would adversely affect our business.

#### **Our industry is highly competitive.**

The semiconductor industry is highly competitive and includes hundreds of companies, a number of which have achieved substantial market share. Current and prospective customers for our products evaluate our capabilities against the merits of our direct competitors. Some of our competitors are well-established as independent companies and have substantially greater market share and manufacturing, financial, research and development and marketing resources than we do. We also compete with emerging companies that are attempting to sell their products in

specialized markets, and with the internal capabilities of many of our significant customers. We expect to experience continuing competitive pressures in our markets from existing competitors and new entrants. Any consolidation among our competitors could enhance their product offerings and financial resources, further enhancing their competitive position. Our ability to compete successfully depends on a number of factors, including the following: our ability to offer cost effective products on a timely basis using our

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technologies; our ability to accurately identify and respond to emerging technological trends and demand for product features and performance characteristics; product introductions by our competitors; our ability to adopt or adapt to emerging industry standards; and the number and nature of our competitors in a given market. Many of these factors are outside of our control. In the future, our competitors may capture our existing or potential customers and our customers may satisfy more of their requirements internally. As a result, we may experience declining revenues and profits.

### **A decline in average selling prices could decrease our profits.**

In the past, our industry has experienced a decline in average selling prices. A decline in average selling prices for our products, if not offset by reductions in the costs of producing such products, would decrease our gross profits and could have a material adverse effect on our business, financial condition and results of operations.

### **Growth in the consumer electronics and other end markets for our products is an important component in our success.**

Our continued success will depend in part on the growth of various consumer electronics markets and other end markets that use our semiconductors and on general economic growth. To the extent that we cannot offset recessionary periods or periods of reduced growth that may occur in these markets through greater penetration of these markets, our sales may decline and our business, financial condition and results of operations may suffer as a result.

### **We depend on successful technological advances for growth.**

Our industry is subject to rapid technological change and product obsolescence as customers and competitors create new and innovative products and technologies. Products or technologies developed by other companies may render our products or technologies obsolete or noncompetitive and we may not be able to access leading edge process technologies or to license or otherwise obtain essential intellectual property required by our customers. Our inability to continue identifying new product opportunities, or manufacturing technologically advanced products on a cost-effective basis, may result in decreased revenues and a loss of market share to our competitors.

### **We may not be able to attract or retain the technical or management employees necessary to remain competitive in our industry.**

We depend on our ability to attract and retain skilled technical and managerial personnel. We could lose the services of, or fail to recruit, skilled personnel, which could hinder our research and product development programs or otherwise have a material adverse effect on our business.

### **If we encounter future labor problems, we may fail to deliver our products in a timely manner which could adversely affect our revenues and profitability.**

As of August 1, 2007, approximately 61.3% of our employees were represented by the MagnaChip Semiconductor Labor Union, which is a member of the Federation of Korean Metal Workers Trade Unions. We cannot assure you that issues with the labor union and other employees will be resolved favorably for us in the future, that we will not experience significant work stoppages in future years or that we will not record significant charges related to those work stoppages.

### **We may incur costs to engage in future business combinations or strategic investments and the anticipated benefits of those transactions may not be realized.**

As part of our business strategy, we may seek to enter into business combinations, investments, joint ventures and other strategic alliances with other companies in order to maintain and grow revenue and market presence as well as to provide us with access to technology, products and services. Those transactions would be accompanied by risks that may harm our business, such as difficulties in assimilating the operations, personnel and products of an acquired business or in realizing the projected benefits; disruption of our ongoing business; potential increases in our indebtedness and contingent liabilities; and charges if the acquired company or assets are later worth less than the amount paid for them pursuant to the acquisition of the Company's business from Hynix Semiconductor Inc. on October 6, 2004. In addition, our senior secured credit facility and the indentures governing our notes may prohibit us from making acquisitions that we may otherwise wish to pursue.

### **We depend on high utilization of our manufacturing capacity.**

As many of our costs are fixed, a reduction in capacity utilization, together with other factors such as yield and product mix, could reduce our profit margins and adversely affect our operating results. A number of factors and circumstances may reduce utilization rates, including periods

of industry overcapacity, low levels of customer orders, operating inefficiencies,

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mechanical failures and disruption of operations due to expansion or relocation of operations, power interruptions, fire, flood or other natural disasters or calamities.

### **The failure to achieve acceptable manufacturing yields could adversely affect our business.**

The manufacture of semiconductors requires precision, a highly-regulated and sterile environment and expensive equipment. We may have difficulty achieving acceptable yields in the manufacture of our products. Slight impurities or defects in the masks used to print circuits on a wafer or other factors can cause significant difficulties, particularly in connection with the production of a new product, the adoption of a new manufacturing process or any expansion of our manufacturing capacity and related transitions.

### **We rely on certain subcontractors.**

The majority of our net sales are derived from semiconductor devices assembled in advanced packages. The packaging of semiconductors is a complex process requiring, among other things, a high degree of technical skill and advanced equipment. We outsource our semiconductor packaging to subcontractors, most of which are located in Korea and Southeast Asia. We rely on these subcontractors to package our devices with acceptable quality and yield levels. If our semiconductor packagers experience problems in packaging our semiconductor devices or experience prolonged quality or yield problems, our operating results could be adversely affected.

### **We depend on successful parts and materials procurement for our manufacturing processes.**

We use a wide range of parts and materials in the production of our semiconductors, including silicon, processing chemicals, processing gases, precious metals and electronic and mechanical components. We procure materials and electronic and mechanical components from domestic and foreign sources and original equipment manufacturers. If we cannot obtain adequate materials in a timely manner or on favorable terms for the manufacture of our products, either or both of our revenues or profits will decline.

### **We face product liability risks and the risk of negative publicity if our products fail.**

Our semiconductors are incorporated into a number of end products, and our business is exposed to product liability risk and the risk of negative publicity if our products fail. Although we maintain insurance for product liability claims, the amount and scope of our insurance may not be adequate to cover a product liability claim that is asserted against us. In addition, product liability insurance could become more expensive and difficult to maintain and, in the future, may not be available on commercially reasonable terms or at all.

In addition, we are exposed to the product liability risk and the risk of negative publicity affecting our customers and suppliers. Our sales may decline if any of our customers are sued on a product liability claim. We may also suffer a decline in sales from the negative publicity associated with such a lawsuit or with adverse public perceptions in general regarding our customers' products.

### **Our ability to compete successfully and achieve future growth will depend, in part, on our ability to protect our proprietary technology, as well as our ability to operate without infringing the proprietary rights of others.**

We seek to protect our proprietary technologies and know-how through the use of patents, trade secrets, confidentiality agreements and other security measures. The process of seeking patent protection takes a long time and is expensive. We cannot assure you that patents will issue from pending or future applications or that, if patents issue, they will not be challenged, invalidated or circumvented, or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage. Some of our technologies are not covered by any patent or patent application. The confidentiality agreements on which we rely may be breached and may not be adequate to protect our proprietary technologies. We cannot assure you that other countries in which we market our services will protect our intellectual property rights to the same extent as the United States.

Our ability to compete successfully depends on our ability to operate without infringing the proprietary rights of others. We have no means of knowing what patent applications have been filed in the United States until they are published. In addition, the semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. Litigation, which could result in substantial costs to us and diversion of our resources, may also be necessary to enforce our patents or other intellectual property rights or to defend against claimed infringement of the rights of others. In the event of an adverse outcome in any such litigation, we may be required to pay substantial damages, indemnify customers or licensees for damages they may suffer if the products they purchase from us or the technology they license from us violate the intellectual property rights of others; stop our manufacture, use, sale or importation of infringing products; expend significant resources to develop or acquire non-infringing technologies; discontinue processes; or obtain licenses to the



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intellectual property we are found to have infringed. We cannot assure you that we would be successful in such development or acquisition or that such licenses would be available under reasonable terms, or at all.

Our competitors may develop, patent or gain access to know-how and technology similar to our own. Failure to protect our existing intellectual property rights may result in the loss of valuable technologies or our having to pay other companies for infringing on their intellectual property rights.

### **We are subject to many environmental laws and regulations that could affect our operations or result in significant expenses.**

We are subject to requirements of environmental, health and safety laws and regulations in each of the jurisdictions in which we operate, governing, among other things, air emissions, wastewater discharges, the generation, use, handling, storage and disposal of, and exposure to, hazardous substances (including asbestos) and wastes, soil and groundwater contamination and employee health and safety. These laws and regulations are complex, constantly changing and have tended to become more stringent over time. We cannot assure you that we have been, or will be at all times, in complete compliance with all these laws and regulations or that we will not incur material costs or liabilities in connection with these laws and regulations in the future. The adoption of new environmental, health and safety laws, the failure to comply with new or existing laws, or issues relating to hazardous substances could subject us to material liability (including substantial fines or penalties), impose the need for additional capital equipment or other process requirements upon us, curtail our operations, or restrict our ability to expand operations.

### **We could suffer adverse tax and other financial consequences as a result of changes in, or differences in the interpretation of, applicable tax laws.**

Our company organizational structure is based, in part, on assumptions about the various tax laws, including withholding tax, and other laws of applicable non-U.S. jurisdictions. In addition, our Korean subsidiary was granted a limited tax-holiday under Korean law in October 2004, which provides for certain tax exemptions for corporate taxes, withholding taxes, acquisition taxes, property and land taxes and other taxes for five years. Our interpretations and conclusions are not binding on any taxing authority, and, if our assumptions about tax and other laws are incorrect or if the authorities were to change or modify the relevant laws, we could suffer adverse tax and other financial consequences or have the anticipated benefits of our company organizational structure materially impaired.

### **A limited number of persons indirectly control us.**

Court Square Capital Partners, Francisco Partners L.P., and CVC Asia Pacific Limited own approximately 34.0%, 34.0% and 18.3%, respectively, of the outstanding voting interests in MagnaChip. By virtue of their ownership of these voting interests, and the securityholders agreement among MagnaChip and its unitholders, these entities have significant influence over our management and will be able to determine the outcome of all matters required to be submitted to the unitholders for approval, including the election of a majority of our directors and the approval of mergers, consolidations and the sale of all or substantially all of our assets.

### **We may need additional capital in the future and it may not be available on acceptable terms or at all.**

We may require more capital in the future to fund our operations, finance investments in equipment and infrastructure, and respond to competitive pressures and potential strategic opportunities. Additional capital may not be available when needed or, if available, may not be available on satisfactory terms. If we are unable to obtain capital on favorable terms, or if we are unable to obtain capital at all, we may have to reduce our operations or forego opportunities and it may have a material adverse effect on our business, financial condition and results of operations.

### **Our international operations are subject to various risks that may lead to decreases in financial results.**

We face risks inherent in international operations, such as unexpected changes in regulatory requirements, tariffs and other market barriers, political, social and economic instability, adverse tax consequences, war, civil disturbances and acts of terrorism, difficulties in accounts receivables collection, extended payment terms and differing labor standards, enforcement of contractual obligations and protection of intellectual property. These risks may lead to increased costs or decreased revenue growth, or both.

### **Any increase in tensions with North Korea could adversely affect our business, financial condition, and results of operations.**

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Relations between Korea and North Korea have been tense throughout Korea's modern history. The level of tension between Korea and North Korea has fluctuated and may increase or change abruptly as a result of current and future events.



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Although we do not derive any revenue from, nor sell any products in, North Korea, any future increase in tensions which may occur, for example, the breakdown of high-level contacts between Korea and North Korea or the occurrence of military hostilities, could adversely affect our business, financial condition and results of operations.

### **We are subject to risks associated with currency fluctuations.**

Our revenues are denominated in various currencies, specifically, the Korean Won, Japanese Yen, Euro and U.S. dollar. As a result, changes in the exchange rates of these currencies or any other applicable currencies to the U.S. dollar will affect the translated price of products and therefore operating margins and could result in exchange losses.

The majority of our costs are denominated in Korean Won and to a lesser extent in Japanese Yen, U.S. dollar and Euro. Therefore, changes in the exchange rates of these currencies or any other applicable currencies to the U.S. dollar will affect cost of goods sold and operating margins and could result in exchange losses.

We cannot fully predict the impact of future exchange rate fluctuations on our profitability. From time to time, we may have engaged in, and may continue to engage in, exchange rate hedging activities in an effort to mitigate the impact of exchange rate fluctuations. However, we cannot assure you that any hedging technique we implement will be effective. If it is not effective, we may experience reduced operating margins.

### **Our expenses could increase if Hynix were unwilling or unable to provide certain services related to our shared facilities with Hynix.**

Because we share certain facilities with Hynix, a few services that are essential to our business are provided to us by or through Hynix. These services include electricity, bulk gasses and de-ionized water, campus facilities, wastewater and sewage management, and environmental safety. If any of our agreements with Hynix were terminated or if Hynix were unwilling or unable to fulfill its obligations to us under the terms of these agreements, we would have to procure these services on our own and as a result may experience an increase in our expenses.

In addition, we lease building and warehouse space from Hynix in Cheongju, Korea, and lease to Hynix some of the space we own in Cheongju, Korea. If Hynix were to become insolvent, we could lose our leases on some of our building and warehouse space.

### **Research and development investments may not yield profitable and commercially viable products and thus will not necessarily result in increases in revenues for us.**

We invest significant resources in our research and development. However, research and development efforts may not yield commercially viable products. During each stage of research and development there is a substantial risk that we will have to abandon a potential product which is no longer marketable and in which we have invested significant resources. In the event we are able to develop viable new products, a significant amount of time will have elapsed between our investment in the necessary research and development effort and the receipt of any related revenues.

### **Investor confidence may be adversely impacted if we are unable to comply with Section 404 of the Sarbanes-Oxley Act of 2002.**

Beginning with our fiscal year ending December 31, 2007, we will be subject to rules adopted by the SEC pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, which require us to include in our Annual Report on Form 10-K our management's report on, and assessment of the effectiveness of, our internal controls over financial reporting. Beginning with our fiscal year ending December 31, 2008, our independent auditors will be required to attest to and report on management's assessment of the effectiveness of our internal controls over financial reporting. If we fail to achieve and maintain the adequacy of our internal controls, there is a risk that we will not comply with all of the requirements imposed by Section 404. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could harm our business and could negatively impact the market price of our securities.

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**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

On May 4, 2007, a former executive of the Company exercised options to acquire 80,000 of our common units at a purchase price of \$80,000.00. These securities were exempt from registration under Section 4(2) of the Securities Act of 1933, as amended, by reason of the fact that the offering was a limited private placement to one knowledgeable investor who agreed not to resell the securities to the public.

**Item 6. Exhibits.**

**Exhibit**

<b>Number</b>	<b>Description</b>
10.3.h	Waiver to Credit Agreement, dated as of August 13, 2007, by and among MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Lenders party thereto, and UBS AG, Stamford Branch, as administrative agent and collateral agent.
31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Executive Officer.
31.2	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer.
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer.

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**SIGNATURES**

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.

MAGNACHIP SEMICONDUCTOR LLC

Dated: August 9, 2007

By: /s/ Sang Park  
Sang Park  
Chief Executive Officer and Chairman

Dated: August 9, 2007

By: /s/ Robert J. Krakauer  
Robert J. Krakauer  
President and Chief Financial Officer

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INDEX TO EXHIBITS

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