

MAGNACHIP SEMICONDUCTOR LLC
Form 10-Q
May 16, 2007
[Table of Contents](#)

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 April 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.

Not Applicable

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

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

Luxembourg, Grand Duchy of Luxembourg

(Address of principal executive offices)

(Zip Code)

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

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 May 1, 2007, the registrant had 52,720,784.0470 of the registrant's common units outstanding.

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

TABLE OF CONTENTS

	Page No.
PART I FINANCIAL INFORMATION	
Item 1. <u>Financial Statements (Unaudited)</u>	1
<u>Condensed Consolidated Statements of Operations</u>	1
<u>Condensed Consolidated Balance Sheets</u>	2
<u>Condensed Consolidated Statements of Changes in Unitholders' Equity</u>	3
<u>Condensed Consolidated Statements of Cash Flows</u>	4
<u>Notes to Condensed Consolidated Financial Statements</u>	5
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	21
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	27
Item 4T. <u>Controls and Procedures</u>	28
PART II OTHER INFORMATION	
Item 1A. <u>Risk Factors</u>	28
Item 6. <u>Exhibits</u>	33
<u>SIGNATURES</u>	34

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)**

	Three months ended	
	April 1, 2007	April 2, 2006
Net sales	\$ 151,783	\$ 213,143
Cost of sales	136,860	172,815
Gross profit	14,923	40,328
Selling, general and administrative expenses	22,729	21,531
Research and development expenses	35,118	29,918
Operating loss	(42,924)	(11,121)
Other income (expenses)		
Interest expense, net	(14,416)	(14,733)
Foreign currency gain (loss), net	(7,391)	24,237
Loss before income taxes	(64,731)	(1,617)
Income tax expenses	2,251	2,274
Net loss	\$ (66,982)	\$ (3,891)
Dividends accrued on preferred units	2,870	2,633
Net loss attributable to common units	\$ (69,852)	\$ (6,524)
Net loss per common units - Basic and diluted	\$ (1.32)	\$ (0.12)
Weighted average number of units - Basic and diluted	52,720,784	53,104,521

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)**

	April 1, 2007	December 31, 2006
Assets		
Current assets		
Cash and cash equivalents	\$ 59,264	\$ 89,173
Accounts receivable, net	80,717	76,665
Inventories, net	69,362	57,846
Other receivables	6,707	6,754
Other current assets	13,914	13,626
Total current assets	229,964	244,064
Property, plant and equipment, net	304,523	336,279
Intangible assets, net	130,458	139,729
Other non-current assets	47,468	49,981
Total assets	\$ 712,413	\$ 770,053
Liabilities and Unitholders' Equity		
Current liabilities		
Accounts payable	\$ 64,181	\$ 62,399
Other accounts payable	26,688	32,423
Accrued expenses	34,807	23,647
Other current liabilities	3,046	2,980
Total current liabilities	128,722	121,449
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	63,381	62,836
Other non-current liabilities	5,051	2,935
Total liabilities	947,154	937,220
Commitments and contingencies		
Series A redeemable convertible preferred units; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at April 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 April 1, 2007 and December 31, 2006	120,244	117,374
Total redeemable convertible preferred units	120,244	117,374
Unitholders' equity		
Common units; 65,000,000 units authorized, 52,720,784 units issued and outstanding at April 1, 2007 and December 31, 2006	52,721	52,721
Additional paid-in capital	2,476	2,451
Accumulated deficit	(441,720)	(370,314)
Accumulated other comprehensive income	31,538	30,601

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

Total unitholders' equity	(354,985)	(284,541)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ 712,413	\$ 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	
	Units	Amount	Paid-In	deficit	Other	Total
			Capital		Comprehensive	
					Income	
Three months ended April 2, 2006						
Balance at January 1, 2006	53,091,570	\$ 53,092	\$ 2,169	\$ (130,092)	\$ 28,347	\$ (46,484)
Exercise of unit options	38,875	38	36			74
Unit-based compensation			74			74
Dividends accrued on preferred units				(2,633)		(2,633)
Comprehensive income :						
Net loss				(3,891)		(3,891)
Fair valuation of derivatives					2,169	2,169
Foreign currency translation adjustments					3,747	3,747
Total comprehensive income						2,025
Balance at April 2, 2006	53,130,445	\$ 53,130	\$ 2,279	\$ (136,616)	\$ 34,263	\$ (46,944)
Three months ended April 1, 2007						
Balance at January 1, 2007	52,720,784	\$ 52,721	\$ 2,451	\$ (370,314)	\$ 30,601	\$ (284,541)
Cumulative impact from adoption of FASB Interpretation						
(FIN) No. 48, <i>Accounting for Uncertainty in Income Taxes</i>						
- an interpretation of SFAS No. 109				(1,554)		(1,554)
Unit-based compensation			25			25
Dividends accrued on preferred units				(2,870)		(2,870)
Comprehensive income (loss):						
Net loss				(66,982)		(66,982)
Fair valuation of derivatives					(917)	(917)
Foreign currency translation adjustments					1,854	1,854
Total comprehensive loss						(66,045)
Balance at April 1, 2007	52,720,784	\$ 52,721	\$ 2,476	\$ (441,720)	\$ 31,538	\$ (354,985)

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)**

	Three months ended	
	April 1, 2007	April 2, 2006
Cash flows from operating activities		
Net loss	\$ (66,982)	\$ (3,891)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	43,942	50,304
Provision for severance benefits	4,182	3,037
Amortization of debt issuance costs	963	870
(Gain) loss on foreign currency translation, net	7,849	(25,758)
Other	(90)	28
Changes in operating assets and liabilities		
Accounts receivable	(4,709)	20,912
Inventories	(12,183)	10,310
Other receivables	42	(1,186)
Accounts payable	2,610	(33,295)
Other accounts payable	(5,606)	(10,801)
Accrued expenses	11,410	5,503
Other current assets	602	(1,945)
Other current liabilities	109	(4,764)
Payment of severance benefits	(2,964)	(2,858)
Other	627	2,036
Net cash provided by (used in) operating activities	(20,198)	8,502
Cash flows from investing activities		
Purchase of plant, property and equipment	(7,821)	(13,541)
Payment for intellectual property registration	(527)	(698)
Proceeds from disposal of plant, property and equipment	9	2,127
Proceeds from disposal of intangible assets		2,755
Decrease in restricted cash		1,849
Other	(547)	(537)
Net cash used in investing activities	(8,886)	(8,045)
Cash flows from financing activities		
Exercise of unit options		74
Net cash provided by financing activities		74
Effect of exchange rates on cash and cash equivalents	(825)	1,487
Net increase (decrease) in cash and cash equivalents	(29,909)	2,018
Cash and cash equivalents		
Beginning of the period	89,173	86,574
End of the period	\$ 59,264	\$ 88,592

The accompanying notes are an integral part of these financial statements

Table of Contents

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 three-month periods ended April 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 April 1, 2007 and December 31, 2006 consist of the following:

	April 1, 2007	December 31, 2006
Finished goods	\$ 12,228	\$ 16,169
Semi-finished goods and work-in-process	51,881	39,492
Raw materials	13,139	11,774
Materials in-transit	2,426	2,063
Less: valuation allowances	(10,312)	(11,652)
Inventories, net	\$ 69,362	\$ 57,846

3. Property, Plant and Equipment

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

	April 1, 2007	December 31, 2006
Buildings and related structures	\$ 160,467	\$ 162,383
Machinery and equipment	370,015	369,683
Vehicles and others	47,082	42,772
	577,564	574,838
Less: accumulated depreciation	(285,375)	(252,814)
Land	12,334	12,481
Construction in-progress		1,774
Property, plant and equipment, net	\$ 304,523	\$ 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 April 1, 2007 and December 31, 2006 are as follows:

	April 1, 2007	December 31, 2006
Technology	\$ 21,038	\$ 21,289
Customer relationships	168,245	170,209
Goodwill	15,095	15,095
Intellectual property assets	10,156	9,742
Less: accumulated amortization	(84,076)	(76,606)
Intangible assets, net	\$ 130,458	\$ 139,729

Goodwill is reviewed at least annually for possible impairment under SFAS No. 142, *Goodwill and other intangible Assets*. Based on our review performed during the current quarter, no impairment charge was taken.

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	
	April 1, 2007	April 2, 2006
Beginning balance	\$ 112	\$ 1,036
Addition to warranty reserve	55	118
Payments made	(79)	(168)
Translation adjustments	(1)	41
Ending balance	\$ 87	\$ 1,027

Table of Contents**MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****6. 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 6⁷/₈% Second Priority Senior Secured Notes. At the same time, such subsidiaries issued \$250 million aggregate principal amount of 8% Senior Subordinated Notes.

Concurrently with the issuance of the Second Priority Senior Secured Notes, the Company entered into a new senior credit agreement with a financial syndicate providing for a \$100 million senior secured revolving credit facility. Interest is charged at current rates when drawn upon.

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

	Maturity	Annual interest rate (%)	Amount of principal
Floating Rate Second Priority Senior Secured Notes	2011	3 month LIBOR + 3.250	\$ 300,000
6 ⁷ / ₈ % 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.

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

As of April 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 April 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.

On March 26, 2007, the Company entered into the Sixth Amendment to Credit Agreement, dated as of March 26, 2007 (the "Sixth Amendment"), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto (the "Lenders"), and UBS AG, Stamford Branch, as administrative agent and collateral agent (the "Agent"). Under the Sixth Amendment, among other things, the existing financial covenants set forth in Section 6.10 of the Credit Agreement were revised to provide that authorized but unspent capital expenditures in a calendar quarter during 2007 carry over to increase the authorized limit on capital expenditures in successive quarters.

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 three-month period ended April 1, 2007, the Company recorded changes in the fair value of the Swap amounting to \$917 thousand, under other comprehensive income in the accompanying condensed consolidated financial statements. In addition, during the same period, the Company recognized interest income of \$952 thousand, which represents the differences between fixed and variable rates.

7. 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 April 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	
	April 1, 2007	April 2, 2006
Beginning balance	\$ 64,642	\$ 56,967
Provisions	4,182	3,037
Severance payments	(2,964)	(2,858)
Effect of foreign currency translation and other	(759)	2,103
Ending balance	65,101	59,249
Less: Cumulative contributions to the National Pension Fund	(819)	(890)
Group Severance insurance plan	(901)	(943)
	\$ 63,381	\$ 57,416

The severance benefits are funded approximately 2.64% and 3.09% as of April 1, 2007 and April 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	69
2010	213

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

2011	75
2012	147
2013 2017	5,087

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)****8. 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. All of the 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 nine months ended April 1, 2007 are as follows:

	Three months ended			
	April 1, 2007		April 2, 2006	
	Units	Amounts	Units	Amounts
Beginning of period	93,997	\$ 117,374	93,997	\$ 106,462
Accrual of preferred dividends		2,870		2,633
End of period	93,997	\$ 120,244	93,997	\$ 109,095

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.

9. Earnings per Unit

The following table illustrates the computation of basic and diluted loss per common unit for the three months ended April 1, 2007 and April 2, 2006:

	Three months ended	
	April 1, 2007	April 2, 2006
Net loss	\$ (66,982)	\$ (3,891)
Dividends to preferred unitholders	2,870	2,633
Net loss attributable to common units	\$ (69,852)	\$ (6,524)
Weighted-average common units outstanding	52,720,784	53,104,521
Basic loss per unit	\$ (1.32)	\$ (0.12)

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:

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

	Three months ended	
	April 1, 2007	April 2, 2006
Redeemable convertible preferred units	93,997	93,997
Options	4,964,903	4,136,580
Warrant		5,079,254

In connection with the acquisition of the Company's business from Hynix Semiconductor Inc. ("Hynix") on October 6, 2004 (the "Original Acquisition"), the Company issued a warrant to Hynix which enables 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.

Table of Contents**MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****10. Equity Incentive Plans**

The Company adopted two equity incentive plans effective October 6, 2004 and March 21, 2005, respectively, which are administered by the Compensation Committee designated by the board of directors. Employees, consultants and non-employee directors are eligible for the grant of options to purchase the Company's common units or restricted common units subject to terms and conditions determined by the Committee. The term of options in no event exceed ten years from the date of grant. As of April 1, 2007, an aggregate maximum of 7,890,864 common units were authorized and reserved for all future and outstanding grants of options.

Unit options are generally granted with exercise prices of no less than the fair market value of the Company's common units on the grant date. Generally, options vest and become exercisable in periodic installments, with 25% of the options vesting on the first anniversary of the grant date and 6.25% of options vesting on the last day of each calendar quarter thereafter. In most cases, the requisite service period, or the period during which a grantee is required to provide service in exchange for option grants, coincides with the vesting period.

Restricted units are issued upon the exercise of certain options to purchase restricted common units. Restricted units issued are subject to restrictions which generally lapse in installments over a four-year period.

The following summarizes unit option and restricted unit activities for the three and nine months ended April 1, 2007:

	Number of restricted units	Number of options	Weighted average exercise price (in US dollar)	Weighted average remaining contractual life
Outstanding at January 1, 2007	621,967	5,069,528	1.6	
Granted		148,500	2.5	
Exercised				
Forfeited / Repurchased		253,125	1.3	
Released from restriction	88,406		n/a	
Outstanding at April 1, 2007	533,561	4,964,903	1.6	8.4 years
Exercisable at April 1, 2007	n/a	1,834,298	1.6	7.7 years

Under SFAS 123(R), the Company is required to measure compensation cost for all unit-based awards at fair value on the date of grant and recognize compensation expense over the grantee's requisite service period. As permitted under SFAS No. 123(R), the Company elected to recognize compensation expense for all options with graded vesting based on the graded attribution method.

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

Total unit option related compensation expense for the three months ended April 1, 2007 and April 2, 2006 were \$25 thousand and \$74 thousand, respectively. As of April 1, 2007, total unrecognized compensation cost of \$271 thousand is expected to be recognized over a weighted average future period of 1.2 years. Total fair value of options vested for the three months ended April 1, 2007 is \$50 thousand.

The Company utilizes the Black-Scholes option-pricing model to measure the fair value of each option grant. The following summarizes the grant-date fair value of options granted during the specified periods and assumptions used in the Black-Scholes option-pricing model on a weighted average basis:

	Three months ended	
	April 1, 2007	April 2, 2006
Grant-date fair value of options (in US dollars)	\$ 0.12	\$ 0.24
Expected term	2.2 years	2.5 years
Risk-free interest rate	4.8%	4.6%
Expected volatility	46.8%	49.0%
Expected dividends		

The expected term of each option grant was based on employees' expected exercises and post-vesting employment termination behavior and the risk free interest rate was based on the U.S. Treasury yield curve for the period corresponding to the expected term at the time of grant. The expected volatility was estimated using historical volatility of share prices of similar public entities. No dividends were assumed for this calculation of option value.

The total cash received from employees as a result of option exercises was \$74 thousand for the three months ended April 2, 2006. There was no option exercise during the three months ended April 1, 2007.

11. Uncertainty in Income Taxes

The Company including its subsidiaries files income tax returns in Japan, Korea, Taiwan, U.S., Hong Kong and U.K. 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 \$6,773 thousand and it related to temporary timing differences. There was no change in total amount of unrecognized tax benefits during the three months ended April 1, 2007.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax expenses. The Company recognized \$39 thousand and \$530 thousand of interest and penalties for the three months ended April 1, 2007 and for the periods up to the adoption date, respectively. Total interest and penalties accrued as of April 1, 2007 and as of the adoption date were \$569 thousand and \$530 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)****12. 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:

	Three months ended	
	April 1, 2007	April 2, 2006
Net Sales		
Display Solutions	\$ 58,870	\$ 85,768
Imaging Solutions	11,772	19,404
Semiconductor Manufacturing Services	57,755	99,375
All other	23,386	8,596
 Total segment net sales	 \$ 151,783	 \$ 213,143
Gross Profit (Loss)		
Display Solutions	\$ 7,089	\$ 17,980
Imaging Solutions	(1,420)	(4,368)
Semiconductor Manufacturing Services	2,847	24,587
All other	6,407	2,129
 Total segment gross profit	 \$ 14,923	 \$ 40,328

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

13. 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 April 1, 2007 and December 31, 2006, condensed consolidating statements of operations and of cash flows for the three months ended April 1, 2007 and April 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 April 1, 2007**

	MagnaChip Semiconductor LLC					
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	\$	\$	\$ 146,606	\$ 56,842	\$ (51,665)	\$ 151,783
Cost of sales			135,714	48,000	(46,854)	136,860
Gross profit			10,892	8,842	(4,811)	14,923
Selling, general and administrative expenses	56	332	18,802	3,412	127	22,729
Research and development expenses			35,298	4,584	(4,764)	35,118
Operating income (loss)	(56)	(332)	(43,208)	846	(174)	(42,924)
Other expenses		(1,106)	(19,988)	(713)		(21,807)
Income (loss) before income taxes, equity in earnings (loss) of related equity investment	(56)	(1,438)	(63,196)	133	(174)	(64,731)
Income tax expenses		43	33	2,175		2,251
Loss before equity in loss of related investment	(56)	(1,481)	(63,229)	(2,042)	(174)	(66,982)
Loss of related investment	(66,926)	(65,445)		(63,590)	195,961	
Net loss	\$ (66,982)	\$ (66,926)	\$ (63,229)	\$ (65,632)	\$ 195,787	\$ (66,982)
Dividends accrued on preferred units	2,870					2,870
Net loss attributable to common units	\$ (69,852)	\$ (66,926)	\$ (63,229)	\$ (65,632)	\$ 195,787	\$ (69,852)

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 April 2, 2006**

	MagnaChip Semiconductor LLC						
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated	
Net sales	\$	\$	\$	208,428	\$ 98,794	\$ (94,079)	\$ 213,143
Cost of sales			172,443	92,364	(91,992)		172,815
Gross profit			35,985	6,430	(2,087)		40,328
Selling, general and administrative expenses	33	248	18,657	2,593			21,531
Research and development expenses			28,742	3,412	(2,236)		29,918
Operating income (loss)	(33)	(248)	(11,414)	425	149		(11,121)
Other income (expenses)		4,315	11,210	(6,021)			9,504
Income (loss) before income taxes, equity in earnings (loss) of related equity investment	(33)	4,067	(204)	(5,596)	149		(1,617)
Income tax expenses		41		2,233			2,274
Income (loss) before equity in earnings (loss) of related investment	(33)	4,026	(204)	(7,829)	149		(3,891)
Loss of related investment	(3,858)	(6,741)		(496)	11,095		
Net loss	\$ (3,891)	\$ (2,715)	\$ (204)	\$ (8,325)	\$ 11,244		\$ (3,891)
Dividends accrued on preferred units	2,633						2,633
Net loss attributable to common units	\$ (6,524)	\$ (2,715)	\$ (204)	\$ (8,325)	\$ 11,244		\$ (6,524)

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****April 1, 2007**

	MagnaChip Semiconductor LLC					
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Assets						
Current assets						
Cash and cash equivalents	\$ 319	\$ 1,734	\$ 45,434	\$ 11,777	\$	\$ 59,264
Accounts receivable, net			93,454	42,169	(54,906)	80,717
Inventories, net			67,363	2,020	(21)	69,362
Other receivables		718	5,708	26,440	(26,159)	6,707
Other current assets	41	20,487	14,306	10,424	(31,344)	13,914
Total current assets	360	22,939	226,265	92,830	(112,430)	229,964
Property, plant and equipment, net			302,669	1,854		304,523
Intangible assets, net			108,853	21,793	(188)	130,458
Investments in subsidiaries	(235,064)	(311,255)		(140,707)	687,026	
Long-term inter-company loans		793,927		634,149	(1,428,076)	
Other non-current assets		19,709	39,857	10,139	(22,237)	47,468
Total assets	(234,704)	525,320	677,644	620,058	(875,905)	712,413
Liabilities and Unitholders equity						
Current liabilities						
Accounts payable	\$	\$	\$ 74,016	\$ 45,071	\$ (54,906)	\$ 64,181
Other accounts payable		5	49,051	3,791	(26,159)	26,688
Accrued expenses	37	11,598	29,731	21,563	(28,122)	34,807
Other current liabilities		375	1,356	4,537	(3,222)	3,046
Total current liabilities	37	11,978	154,154	74,962	(112,409)	128,722
Long-term borrowings		750,000	621,000	807,076	(1,428,076)	750,000
Accrued severance benefits, net			63,072	309		63,381
Other non-current liabilities			3,312	23,976	(22,237)	5,051
Total liabilities	37	761,978	841,538	906,323	(1,562,722)	947,154
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred unites	120,244					120,244

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

Total redeemable convertible preferred units	120,244					120,244
Unitholders' equity						
Common units	52,721	136,229	39,005	55,778	(231,012)	52,721
Additional paid-in capital	2,476	1,417	155,431	108,264	(265,112)	2,476
Accumulated deficit	(441,720)	(406,592)	(388,141)	(479,674)	1,274,407	(441,720)
Accumulated other comprehensive income	31,538	32,288	29,811	29,367	(91,466)	31,538
Total unitholders' equity	(354,985)	(236,658)	(163,894)	(286,265)	686,817	(354,985)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ (234,704)	\$ 525,320	\$ 677,644	\$ 620,058	\$ (875,905)	\$ 712,413

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						
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations		Consolidated
Assets							
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			334,809	1,470			336,279
Intangible assets, net			117,101	22,628			139,729
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
Liabilities and Unitholders equity							
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		750,000	621,000	804,635	(1,425,635)		750,000
Accrued severance benefits, net			62,550	286			62,836
Other non-current liabilities			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

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

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 three months ended April 1, 2007**

	MagnaChip Semiconductor LLC					
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Cash flow from operating activities:						
Net loss	\$ (66,982)	\$ (66,926)	\$ (63,229)	\$ (65,632)	\$ 195,787	\$ (66,982)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			42,932	1,010		43,942
Provision for severance benefits			4,162	20		4,182
Amortization of debt issuance costs		722	241			963
(Gain) loss on foreign currency translation, net		(2,279)	7,773	2,355		7,849
Loss of related investment	66,926	65,445		63,590	(195,961)	
Other		(1)	(97)	8		(90)
Changes in operating assets and liabilities:						
Accounts receivable			(7,492)	(7,329)	10,112	(4,709)
Inventories			(12,370)	206	(19)	(12,183)
Other receivables			(457)	1,681	(1,182)	42
Accounts payable			7,659	5,063	(10,112)	2,610
Other accounts payable			(2,635)	(4,153)	1,182	(5,606)
Accrued expenses	36	8,463	7,948	4,478	(9,515)	11,410
Other current assets	18	(4,626)	34	(3,539)	8,715	602
Other current liabilities		43	(475)	(265)	806	109
Payment of severance benefits			(2,964)			(2,964)
Other		1	281	(304)	649	627
Net cash provided by (used in) operating activities	(2)	842	(18,689)	(2,811)	462	(20,198)
Cash flows from investing activities:						
Purchase of plant, property and equipment			(7,295)	(526)		(7,821)
Payment for intellectual property registration			(687)	(34)	194	(527)
Proceeds from disposal of plant, property and equipment				9		9
Other			(4)	(543)		(547)
Net cash used in investing activities			(7,986)	(1,094)	194	(8,886)
Cash flows from financing activities:						
Net cash provided by financing activities			(499)	330	(656)	(825)

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

Effect of exchange rate on cash and cash equivalents

Net increase (decrease) in cash and cash equivalents	(2)	842	(27,174)	(3,575)	(29,909)
--	-----	-----	----------	---------	----------

Cash and cash equivalents:

Beginning of the period	321	892	72,608	15,352	89,173
-------------------------	-----	-----	--------	--------	--------

End of the period	\$ 319	\$ 1,734	\$ 45,434	\$ 11,777	\$ 59,264
-------------------	--------	----------	-----------	-----------	-----------

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 three months ended April 2, 2006**

	MagnaChip Semiconductor LLC					
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Cash flow from operating activities:						
Net loss	\$ (3,891)	\$ (2,715)	\$ (204)	\$ (8,325)	\$ 11,244	\$ (3,891)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			49,240	1,064		50,304
Provision for severance benefits			3,014	23		3,037
Amortization of debt issuance costs		648	222			870
(Gain) loss on foreign currency translation, net		(3,825)	(25,979)	4,046		(25,758)
Loss of related investment	3,858	6,741		496	(11,095)	
Other			236	(208)		28
Changes in operating assets and liabilities:						
Accounts receivable			4,465	14,128	2,319	20,912
Inventories			10,706	(285)	(111)	10,310
Other receivables	(1)		(1,728)	(115)	658	(1,186)
Accounts payable			(32,937)	1,961	(2,319)	(33,295)
Other accounts payable			(10,483)	340	(658)	(10,801)
Accrued expenses		8,561	3,104	8,385	(14,547)	5,503
Other current assets		(9,711)	(2,302)	(5,291)	15,359	(1,945)
Other current liabilities		41	(593)	(3,400)	(812)	(4,764)
Payment of severance benefits			(2,858)			(2,858)
Other		(123)	2,852	(693)		2,036
Net cash provided by (used in) operating activities	(34)	(383)	(3,245)	12,126	38	8,502
Cash flows from investing activities:						
Purchase of plant, property and equipment			(13,237)	(304)		(13,541)
Payment for intellectual property registration			(698)			(698)
Proceeds from disposal of plant, property and equipment			2,109	18		2,127
Proceeds from disposal of intangible assets			2,755			2,755
Decrease in restricted cash			1,849			1,849
Other			(559)	22		(537)
Net cash used in investing activities			(7,781)	(264)		(8,045)

Cash flows from financing activities:

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

Exercise of unit options	74					74
Net cash provided by financing activities	74					74
Effect of exchange rate on cash and cash equivalents			1,492	33	(38)	1,487
Net increase (decrease) in cash and cash equivalents	40	(383)	(9,534)	11,895		2,018
Cash and cash equivalents:						
Beginning of the period	209	841	63,435	22,089		86,574
End of the period	\$ 249	\$ 458	\$ 53,901	\$ 33,984	\$	\$ 88,592

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, 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**

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

	Three months ended April 1, 2007		Three months ended April 2, 2006		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	<i>(in millions of US dollars; %)</i>					
Net sales	\$ 151.8	100.0	\$ 213.1	100.0	\$ (61.3)	(28.8)
Cost of sales	136.9	90.2	172.8	81.1	(35.9)	(20.8)
Gross profit	14.9	9.8	40.3	18.9	(25.4)	(63.0)
Selling, general and administrative expenses	22.7	15.0	21.5	10.1	1.2	5.6
Research and development expenses	35.1	23.1	29.9	14.0	5.2	17.4
Operating loss	(42.9)	(28.3)	(11.1)	(5.2)	(31.8)	286.5
Interest expense, net	(14.4)	(9.5)	(14.7)	(6.9)	0.3	(2.0)
Foreign currency gain, net	(7.4)	(4.9)	24.2	11.4	(31.6)	(130.6)
Loss before income taxes	(64.7)	(42.7)	(1.6)	(0.7)	(63.1)	3,943.7
Income tax expenses	2.3	1.5	2.3	1.1	0.0	0.0
Net loss	\$ (67.0)	(44.2)	\$ (3.9)	(1.8)	\$ (63.1)	1,617.9

Net Sales

	Three months ended April 1, 2007		Three months ended April 2, 2006		Change	
	Amount	% of total	Amount	% of total	Amount	%
	<i>(in millions of US dollars; %)</i>					
Display solutions	\$ 58.9	38.8	\$ 85.7	40.2	\$ (26.8)	(31.3)
Imaging solutions	11.8	7.8	19.4	9.1	(7.6)	(39.2)
Semiconductor Manufacturing Services	57.7	38.0	99.4	46.6	(41.7)	(42.0)
All other	23.4	15.4	8.6	4.1	14.8	172.1
	\$ 151.8	100.0	\$ 213.1	100.0	\$ (61.3)	(28.8)

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 April 1, 2007 decreased \$61.3 million, or 28.8% compared to the three months ended April 2, 2006. Net sales generated in the three operating segments during the current quarter were \$128.4 million, a decrease of \$76.1 million or 37.2% from the net sales of three operating segments for prior-year quarter.

Display Solutions. Net sales from Display Solutions for the three months ended April 1, 2007 were \$58.9 million, a \$26.8 million or 31.3% decrease from \$85.7 million for the three months ended April 2, 2006. This sales decrease in our display driver business was primarily attributable to overall downturn in display products market. Along with demand decrease in the end-market, both sales volume and average selling price were reduced resulting in significant decrease in the revenue.

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

Imaging Solutions. Imaging Solutions net sales decreased \$7.6 million in the current quarter, or 39.2% compared to net sales generated in the prior-year quarter. This decrease was primarily attributable to missed opportunities from our delays in transition to new mega-pixel products, which was expected to substitute our VGA products. Revenue from our traditional VGA products decreased due to lower market demand and a decline in average selling price.

Semiconductor Manufacturing Services. Net sales from Semiconductor Manufacturing Services for the first quarter of 2007, were \$57.7 million, a \$41.7 million or 42.0% decrease compared to net sales of \$99.4 million for the prior-year quarter. This decrease was mainly due to an inventory correction in the analog and power areas of our foundry business, coupled with continued average selling price erosion.

Table of Contents

All other. Net sales from All other for the three months ended April 1, 2007 were \$23.4 million compared to \$8.6 million for the three months ended April 2, 2006. This increase of \$14.8 million substantially represents revenue increase from our unit processing service rendered to Hynix.

Gross Profit

	Three months ended April 1, 2007		Three months ended April 2, 2006		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
<i>(in millions of US dollars; %)</i>						
Display solutions	\$ 7.1	12.1	\$ 18.0	21.0	\$ (10.9)	(60.6)
Imaging solutions	(1.4)	(11.9)	(4.4)	(22.7)	3.0	(68.2)
Semiconductor Manufacturing Services	2.8	4.9	24.6	24.7	(21.8)	(88.6)
All other	6.4	27.4	2.1	24.4	4.3	204.8
	\$ 14.9	9.8	\$ 40.3	18.9	\$ (25.4)	(63.0)

Total gross profit decreased \$25.4 million in the first quarter of 2007, or 63.0%, compared to the gross profit generated in the first quarter of 2006. Gross margin percentage for current quarter was 9.8% of net sales, a decrease of 9.1% from 18.9% for prior-year quarter. This decline in gross margin percentage was primarily attributable to lower utilization of our manufacturing capacity as a result of substantial sales decreases, coupled with an overall decrease in average selling prices.

Display Solutions. Gross margin percentage for Display Solutions for the three months ended April 1, 2007 declined to 12.1% compared to 21.0% for the three months ended April 2, 2006. This decline in gross margin percentage was primarily attributable to lower average selling price and higher overhead cost per-unit driven by a decrease in unit volume.

Imaging Solutions. Imaging Solutions reported gross loss for both quarters due to low revenues resulting from a weak market position for new mega pixel products and decreases in sales for VGA products. However, gross margin percentage for the current period was improved compared to the prior period 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 4.9% in the first quarter of 2007 from 24.7% in the first quarter of 2006. The year-over-year decrease was primarily attributable to lower margin mix within the segment, coupled with lower revenue.

All other. Gross margin percentage for All other for the current period increased to 27.4% from 24.4% for the prior period. This improvement in gross margin percentage is mainly attributable to sales volume increase for unit processing, which resulted in lower fixed cost per unit.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general, and administrative expenses were \$22.7 million or 15.0% of net sales for the three months ended April 1, 2007 compared to \$21.5 million or 10.1% for the three months ended April 2, 2006. The increase of \$1.2 million or 5.6% from the prior-year quarter was primarily attributable to employee related expenses such as salaries and benefits which 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 quarter were \$35.1 million, an increase of \$5.2 million or 17.4% from \$29.9 million for the prior year quarter. This year-over-year increase in research and development expenses essentially represented our focus on the introduction of new products, especially for the Imaging Solutions and Display Solutions segments. As a percentage of net sales, research and development expenses for the current quarter increased to 23.1% compared to 14.0% for the prior-year quarter.

Net Interest Expense and Net Foreign Currency Gain or Loss

Net Interest Expense. Net interest expense was \$14.4 million during the three-month period ended April 1, 2007, relatively consistent with \$14.7 million for the three-month period ended April 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 decline in net interest expense was mainly due to an increase in interest income from

financial assets including cash and cash equivalents.

Table of Contents

Net Foreign Currency Gain or Loss. Net foreign currency loss for the three months ended April 1, 2007 was \$7.4 million, compared to net foreign exchange gain of \$24.2 million for the three months ended April 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 current quarter were \$2.3 million, consistent with income tax expenses of \$2.3 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 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, if drawn upon, 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 April 1, 2007, we had total outstanding long-term debt of \$750.0 million.

Our principle sources of liquidity are our cash, cash equivalents and available borrowings under our senior credit facility of \$100 million. As of April 1, 2007, our cash and cash equivalents balance was \$59.3 million or 8.3% of our total assets, a \$29.9 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 quarter of 2007 was primarily attributable to cash outflow of \$20.2 million in operating activities, coupled with cash outflow associated with quarterly capital expenditures of \$8.3 million.

During the three-month period ended April 1, 2007, net cash used in operating activities was \$20.2 million, compared to \$8.5 million of net cash provided 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 \$25.4 million resulting mainly from lower revenue. The net operating cash outflow for the current quarter principally reflects our net loss of \$67.0 million adjusted by \$43.9 million of depreciation and amortization costs.

Our working capital balance as of April 1, 2007 was \$101.2 million compared to \$122.6 million as of December 31, 2006. The decrease of \$21.4 million in our working capital balance was mainly due to a \$29.9 million reduction in cash and cash equivalents driven by foregoing reasons. This decrease in cash and cash equivalents was partially offset by inventory build-up of \$11.5 million representing expected sales growth in the coming periods.

For investing activities, net cash outlay during the first quarter of 2007 was \$8.9 million, compared to \$8.0 million in the prior-year quarter. In the prior-year quarter, cash outlay for our capital expenditures was offset by a cash inflow from the sale of our application processor business.

For the three months ended April 1, 2007, there were no significant financing activities, consistent with the prior year quarter.

Capital Expenditures. For the three months ended April 1, 2007, capital expenditures were \$8.3 million, a \$5.9 million or 41.5% decrease from \$14.2 million for the three months ended April 2, 2006 as a result of the management of the timing of capital expenditures. 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 April 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							
Secured notes and subordinated notes(*)	750.0					500.0	250.0
Operating lease	41.4	8.4	11.0	11.0	11.0		
Others	6.1	5.2	1.1				(0.2)

(*) Excludes interest obligations on notes.

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%, 6⁷/8% 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 March 26, 2007, the Company entered into the Sixth Amendment to Credit Agreement, dated as of March 26, 2006 (the Sixth Amendment), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto, and the Agent. Under the Sixth Amendment, among other things, the existing financial covenants set forth in Section 6.10 of the Credit Agreement were revised to provide that authorized but unspent capital expenditures in a calendar quarter during 2007 carry over to increase the authorized limit on capital expenditures in successive quarters.

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 our 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 April 1, 2007 and December 31, 2006 were \$94.6 million and \$93.8 million, respectively. The utilized portions of the credit line are related to the issuance of letters of credit rather than 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.

Table of Contents

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 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.

Table of Contents***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.

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 April 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 \$2.1 million in our U.S. dollar financial instruments balance and cash balance.

Interest Rate Risk. The \$200 million 6⁷/₈% 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 April 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 April 1, 2007. The fair value of these fixed rate notes would have decreased by \$8.2 million or increased by \$8.5 million with a 10% increase or decrease in the interest rate, respectively.

Table of Contents

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.

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.

Edgar Filing: MAGNACHIP SEMICONDUCTOR LLC - Form 10-Q

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.

Table of Contents

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 151 customers in the three-month period ended April 1, 2007, net sales to our 10 largest customers represented approximately 71.0% 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 three months ended April 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 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.

Table of Contents

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 May 1, 2007, approximately 60.2% 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 in the Original Acquisition. 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, 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.

Table of Contents

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 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.

Table of Contents

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.

CVC, Francisco Partners, and CVC Asia Pacific own approximately 34.1%, 34.1% 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.

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. 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.

Table of Contents

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.

Item 6. Exhibits.

Exhibit

Number	Description
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.

Table of Contents

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: May 14, 2007

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

Dated: May 14, 2007

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

Table of Contents

INDEX TO EXHIBITS

Exhibit

Number	Description
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.