MAGNACHIP SEMICONDUCTOR LLC
Form 10-Q
August 13, 2008
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 29, 2008

or

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

Commission file number 333-126019-09

MAGNACHIP SEMICONDUCTOR LLC

(Exact name of Registrant as specified in its charter)

Delaware **(State or other jurisdiction of** **incorporation or organization)**	**83-0406195** **(I.R.S. Employer** **Identification No.)**
c/o MagnaChip Semiconductor S.A. **74, rue de Merl, B.P. 709, L-2017** **Luxembourg, Grand Duchy of Luxembourg** **(Address of principal executive offices)**	**Not Applicable** **(Zip Code)**

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

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

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

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

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

As of August 1, 2008, the registrant had 52,923,482.797 of the registrant s common units outstanding.

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

TABLE OF CONTENTS

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		Six months ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net sales	$ 194,676	$ 194,053	$ 397,728	$ 345,836
Cost of sales	145,522	166,299	300,708	303,159
Gross profit	49,154	27,754	97,020	42,677
Selling, general and administrative expenses	23,010	25,531	42,234	48,260
Research and development expenses	35,494	32,534	71,841	67,652
Restructuring and impairment charges		12,084	(875)	12,084
Operating loss	(9,350)	(42,395)	(16,180)	(85,319)
Other income (expenses)				
Interest expense, net	(15,816)	(14,952)	(31,511)	(29,368)
Foreign currency gain (loss), net	(31,149)	13,868	(74,013)	6,477
Loss before income taxes	(56,315)	(43,479)	(121,704)	(108,210)
Income tax expenses	3,278	1,845	5,786	4,096
Net loss	$ (59,593)	$ (45,324)	$ (127,490)	$ (112,306)
Dividends accrued on preferred units	3,281	2,983	6,399	5,853
Net loss attributable to common units	$ (62,874)	$ (48,307)	$ (133,889)	$ (118,159)
Net loss per common units				
- Basic and diluted	$ (1.19)	$ (0.92)	$ (2.54)	$ (2.24)
Weighted average number of units				
- Basic and diluted	52,736,809	52,772,652	52,658,459	52,746,718

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)

	June 29, 2008	December 31, 2007
Assets		
Current assets		
Cash and cash equivalents	$ 36,503	$ 64,345
Accounts receivable, net	149,212	123,789
Inventories, net	63,532	75,867
Other receivables	5,480	5,771
Other current assets	17,458	10,951
Total current assets	272,185	280,723
Property, plant and equipment, net	246,239	279,669
Intangible assets, net	82,079	104,725
Other non-current assets	44,780	42,766
Total assets	$ 645,283	$ 707,883
Liabilities and Unitholders Equity		
Current liabilities		
Accounts payable	$ 118,058	$ 89,977
Other accounts payable	24,274	30,661
Accrued expenses	20,272	18,100
Short-term borrowings	85,000	80,000
Other current liabilities	3,758	6,377
Total current liabilities	251,362	225,115
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	70,615	74,176
Other non-current liabilities	12,953	6,666
Total liabilities	1,084,930	1,055,957
Commitments and contingencies		
Series A redeemable convertible preferred units; $1,000 par value; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at June 29, 2008 and December 31, 2007		
Series B redeemable convertible preferred units; $1,000 par value; 550,000 units authorized, 450,692 units issued and 93,997 units outstanding at June 29, 2008 and December 31, 2007	135,804	129,405
Total redeemable convertible preferred units	135,804	129,405
Unitholders equity		
Common units; $1 par value; 65,000,000 units authorized, 52,919,108 and 52,844,222 units issued and outstanding at June 29, 2008 and December 31, 2007	52,919	52,844
Additional paid-in capital	2,900	3,077
Accumulated deficit	(698,338)	(564,449)

Accumulated other comprehensive income	67,068	31,049
Total unitholders equity	(575,451)	(477,479)
Total liabilities, redeemable convertible preferred units and unitholders equity	$ 645,283	$ 707,883

The accompanying notes are an integral part of these financial statements

4

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Condensed Consolidated Statements of Changes in Unitholders Equity

(Unaudited; in thousands of US dollars, except unit data)

	Common Units		Additional Paid-In Capital	Accumulated deficit	Accumulated Other Comprehensive Income	Total
	Units	Amount				
Three months ended June 29, 2008						
Balance at March 30, 2008	52,847,472	$ 52,847	$ 3,135	$ (635,464)	$ 51,592	$ (527,890)
Exercise of unit options	143,272	143	1			144
Repurchase of common units	(71,636)	(71)	(357)			(428)
Unit-based compensation			121			121
Dividends accrued on preferred units				(3,281)		(3,281)
Comprehensive income (loss):						
Net loss				(59,593)		(59,593)
Fair valuation of derivatives					779	779
Foreign currency translation adjustments					14,697	14,697
Total comprehensive loss						(44,117)
Balance at June 29, 2008	52,919,108	$ 52,919	$ 2,900	$ (698,338)	$ 67,068	$ (575,451)
Six months ended June 29, 2008						
Balance at January 1, 2008	52,844,222	$ 52,844	$ 3,077	$ (564,449)	$ 31,049	$ (477,479)
Exercise of unit options	157,085	157	15			172
Repurchase of common units	(82,199)	(82)	(414)			(496)
Unit-based compensation			222			222
Dividends accrued on preferred units				(6,399)		(6,399)
Comprehensive income (loss):						
Net loss				(127,490)		(127,490)
Fair valuation of derivatives					(864)	(864)
Foreign currency translation adjustments					36,883	36,883
Total comprehensive loss						(91,471)
Balance at June 29, 2008	52,919,108	$ 52,919	$ 2,900	$ (698,338)	$ 67,068	$ (575,451)

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

(Unaudited; in thousands of US dollars, except unit data)

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

The accompanying notes are an integral part of these financial statements

6

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited; in thousands of US dollars)

	Six months ended	
	June 29, 2008	**July 1, 2007**
Cash flows from operating activities		
Net loss	$ (127,490)	$ (112,306)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	41,882	89,974
Provision for severance benefits	6,890	9,379
Amortization of debt issuance costs	1,988	1,929
(Gain) loss on foreign currency translation, net	73,078	(6,326)
Gain on disposal of property, plant and equipment, net	(3,471)	
Impairment charges		10,106
Other	386	110
Changes in operating assets and liabilities		
Accounts receivable	(36,938)	(40,442)
Inventories	5,142	(13,237)
Other receivables	(74)	(411)
Deferred tax assets	854	
Accounts payable	30,827	18,857
Other accounts payable	(6,005)	(8,135)
Accrued expenses	3,658	392
Other current assets	(70)	3,430
Other current liabilities	(836)	347
Payment of severance benefits	(2,794)	(4,402)
Other	(1,957)	768
Net cash used in operating activities	(14,930)	(49,967)
Cash flows from investing activities		
Purchase of property, plant and equipment	(20,466)	(24,399)
Payment for intellectual property registration	(725)	(561)
Proceeds from disposal of property, plant and equipment	3,473	322
Other	(217)	512
Net cash used in investing activities	(17,935)	(24,126)
Cash flows from financing activities		
Exercise of unit options	172	80
Repurchase of common units	(496)	
Proceeds from short-term borrowings	155,000	40,000
Repayment of short-term borrowings	(150,000)	
Net cash provided by financing activities	4,676	40,080
Effect of exchange rates on cash and cash equivalents	347	(426)
Net decrease in cash and cash equivalents	(27,842)	(34,439)
Cash and cash equivalents		

Beginning of the period		64,345		89,173
End of the period	$	36,503	$	54,734

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. The results of operations for the six-month period ended June 29, 2008 are not necessarily indicative of the results to be expected for a full year or for any other periods.

The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

Recent Accounting Pronouncements

In December 2007, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (SFAS) No. 141 (revised 2007), *Business Combinations* (SFAS 141R), which replaces FASB Statement No. 141. SFAS 141R establishes principles and requirements for how an acquirer recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, any non controlling interest in the acquiree and the goodwill acquired. This statement also establishes disclosure requirements which will enable users to evaluate the nature and financial effects of the business combination. SFAS 141R is effective as of the beginning of an entity s fiscal year that begins after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 141R on its consolidated financial statements.

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statement amendments of ARB No. 51* (SFAS 160). SFAS 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. SFAS 160 also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. SFAS 160 applies to all entities that prepare consolidated financial statements, except not-for-profit organizations, but will affect only those entities that have an outstanding noncontrolling interest in one or more subsidiaries or that deconsolidate a subsidiary. This statement is effective as of the beginning of an entity s first fiscal year beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS 160 on its consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities including an amendment of FASB Statement No. 115* (SFAS 159), which permits all entities to choose to measure many financial instruments and certain other items at fair value and consequently report unrealized gains and losses on these items in earnings. SFAS 159 was effective for the Company s fiscal year beginning January 1, 2008. The Company has not elected the fair value option to measure certain financial instruments. The adoption of SFAS 159 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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

The Company adopted the provisions of SFAS No. 157, *Fair Value Measurements* (SFAS 157) on January 1, 2008. SFAS 157 defines fair value, establishes a market-based framework or hierarchy for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is applicable whenever another accounting pronouncement requires or permits assets and liabilities to be measured at fair value. SFAS 157 does not expand or require any new fair value measures, however the application of this statement may change current practice. In February 2008, the FASB decided that an entity need not apply this standard to nonfinancial assets and liabilities that are recognized or disclosed at fair value in the financial statements on a nonrecurring basis until 2009. Accordingly, the Company s adoption of this standard in 2008 was limited to financial assets and liabilities, which primarily affects the valuation of its derivative contract. The adoption of SFAS 157 did not have a material effect on the Company s financial condition or results of operations. The Company is still in the process of evaluating this standard with respect to its effect on nonfinancial assets and liabilities and therefore has not yet determined the impact that it will have on its consolidated financial statements upon full adoption in 2009. Nonfinancial assets and liabilities for which the Company has not applied the provisions of SFAS 157 include those measured at fair value in impairment testing and those initially measured at fair value in a business combination.

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 June 29, 2008 and December 31, 2007 consist of the following:

	June 29, 2008	December 31, 2007
Finished goods	$ 15,418	$ 19,557
Semi-finished goods and work-in-process	50,094	56,877
Raw materials	5,980	7,498
Materials in-transit	1,325	555
Less: valuation allowances	(9,285)	(8,620)
Inventories, net	$ 63,532	$ 75,867

3. Property, Plant and Equipment

Property, plant and equipment as of June 29, 2008 and December 31, 2007 comprise the following:

	June 29, 2008	December 31, 2007
Buildings and related structures	$ 135,599	$ 150,951
Machinery and equipment	398,474	429,259
Vehicles and others	54,069	54,556
	588,142	634,766
Less: accumulated depreciation	(353,335)	(367,501)
Land	11,142	12,404
Construction in-progress	290	
Property, plant and equipment, net	$ 246,239	$ 279,669

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 June 29, 2008 and December 31, 2007 are as follows:

	June 29, 2008	December 31, 2007
Technology	$ 19,006	$ 21,157
Customer relationships	154,976	169,300
Goodwill	14,245	14,245
Intellectual property assets	8,961	9,320
Less: accumulated amortization	(115,109)	(109,297)
Intangible assets, net	$ 82,079	$ 104,725

Goodwill has resulted from the acquisition of ISRON Corporation on March 6, 2005. On an ongoing basis, the Company evaluates goodwill at the reporting unit level for indications of potential impairment. Goodwill is tested for impairment based on the present value of discounted cash flows, and, if impaired, written down to fair value based on discounted cash flows. The Company performs its annual goodwill impairment test during the first quarter of each fiscal year, as well as any additional impairment test required on an event-driven basis. In the first quarter of each of fiscal 2008 and 2007, the Company performed its annual goodwill impairment test and determined that goodwill was not impaired.

5. Short-term borrowings

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

Presently, borrowings under the credit agreement bear interest equal to the 3-month London Inter-bank Offering Rate (LIBOR) plus 4.75% or Alternate Base Rate (ABR) plus 3.75%. Additionally, the Company is required to pay the administrative agent for the account of each lender a commitment fee equal to 0.5% on the average daily unused amount of the commitment of each lender during the period from December 23, 2004 to but excluding the date on which such commitments terminate. As of June 29, 2008 and December 31, 2007, the Company had borrowed $85 million and $80 million, respectively, under this credit agreement.

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

Short-term borrowings as of June 29, 2008 and December 31, 2007 are presented as below:

	As of June 29, 2008		Amount of principal	
	Maturity	Annual interest rate (%)	June 29, 2008	December 31, 2007
Euro dollar Revolving Loan	2008-06-30 ~ 2008-07-28	3 month LIBOR + 4.75	$ 80,000	$ 30,000
ABR Revolving Loan	2008-06-30	ABR + 3.75	5,000	50,000

	$ 85,000	$ 80,000

11

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 6 7/8% Second Priority Senior Secured Notes. At the same time, such subsidiaries issued $250 million aggregate principal amount of 8% Senior Subordinated Notes.

Details of long-term borrowings as of June 29, 2008 and December 31, 2007 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 are due in full upon maturity.

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

As of June 29, 2008, 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 June 29, 2008, the Company and all of its subsidiaries except for MagnaChip Semiconductor Ltd. (Korea) and MagnaChip Semiconductor (Shanghai) Company Limited have jointly and severally guaranteed the Senior Subordinated Notes on an unsecured, senior subordinated basis. In addition, the Company and each of its current and future direct and indirect subsidiaries (subject to certain exceptions) will be guarantors of the Second Priority Senior Secured Notes and Senior Subordinated Notes.

Interest Rate Swap

Effective June 27, 2005, the Company entered into an interest rate swap agreement (the Swap) to hedge the effect of the volatility of the 3-month London Inter-Bank Offering Rate (LIBOR) resulting from the Company s $300 million of Floating Rate Second Priority Senior Secured Notes (the Notes). Under the terms of the Swap, the Company received a variable interest rate equal to the three-month LIBOR rate plus 3.25%. In exchange, the Company paid interest at a fixed rate of 7.34%. The Swap effectively replaced the variable interest rate on the notes with a fixed interest rate through the expiration date of the Swap on June 15, 2008.

The Swap qualified as a cash flow hedge under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities,* as amended, since at both the inception of the hedge and on an ongoing basis, the hedging relationship was expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. The Company utilized 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.

The Swap agreement expired on 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)

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 June 29, 2008, 98% of all employees of the Company were eligible for severance benefits.

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

	Three months ended		Six months ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Beginning balance	$ 73,672	$ 65,101	$ 75,869	$ 64,642
Provisions	3,156	5,198	6,890	9,379
Severance payments	(1,182)	(1,438)	(2,794)	(4,402)
Effect of foreign currency translation and other	(3,537)	1,321	(7,856)	563
Ending balance	72,109	70,182	72,109	70,182
Less: Cumulative contributions to the National Pension Fund	(681)	(816)	(681)	(816)
Group Severance insurance plan	(813)	(913)	(813)	(913)
	$ 70,615	$ 68,453	$ 70,615	$ 68,453

The severance benefits are funded approximately 2.07% and 2.46% as of June 29, 2008 and July 1, 2007, 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.

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

	Severance benefit
2009	$ 57
2010	35
2011	73
2012	146
2013	182
2014 2018	7,154

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, respectively. All of Series A were redeemed by cash on December 27, 2004 and some of the Series B were redeemed by cash on December 15, 2004 and December 27, 2004.

Changes in Series B for the three and six months ended June 29, 2008 and July 1, 2007 are as follows:

	Three months ended			
	June 29, 2008		July 1, 2007	
	Units	Amount	Units	Amount
Beginning of period	93,997	$ 132,523	93,997	$ 120,244
Accrual of preferred dividends		3,281		2,983
End of period	93,997	$ 135,804	93,997	$ 123,227

	Six months ended			
	June 29, 2008		July 1, 2007	
	Units	Amount	Units	Amount
Beginning of period	93,997	$ 129,405	93,997	$ 117,374
Accrual of preferred dividends		6,399		5,853
End of period	93,997	$ 135,804	93,997	$ 123,227

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-month and six-month periods ended June 29, 2008 and July 1, 2007:

	Three months ended		Six months ended	
	June 29, 2008	July 1, 2007	June 29, 2008	July 1, 2007
Net loss	$ (59,593)	$ (45,324)	$ (127,490)	$ (112,306)
Dividends to preferred unitholders	3,281	2,983	6,399	5,853

Net loss attributable to common units	$	(62,874)	$	(48,307)	$	(133,889)	$	(118,159)
Weighted-average common units outstanding		52,736,809		52,772,652		52,658,459		52,746,718
Basic and diluted loss per unit	$	(1.19)	$	(0.92)	$	(2.54)	$	(2.24)

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

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

	Six months ended	
	June 29, 2008	**July 1, 2007**
Redeemable convertible preferred units	93,997	93,997
Options	4,903,725	4,725,871
Restricted units	179,937	445,155

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

10. Restructuring and Impairment Charges

Assets impairment

During the three months ended July 1, 2007, the Company recognized impairment charges of $10,106 thousand under SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets* (SFAS No. 144). The impairment charges were recorded related to the closure of one of the Company s five-inch wafer fabrication facilities that had generated losses and no longer supported the Company s strategic technology roadmap.

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

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

Restructuring

During the three months ended July 1, 2007, the Company recognized $1,978 thousand of restructuring accruals under SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS No. 146). The restructuring charges were related to the closure of the Company s five-inch wafer fabrication facilities and those charges consisted of one-time termination benefits, transfer of machinery and other associated costs. Up to the first quarter of 2008, actual payments were charged against the restructuring accruals and the Company believes the restructuring activities were substantially completed as of March 30, 2008. Accordingly, the Company reversed $875 thousand of unused restructuring accruals.

11. Uncertainty in Income Taxes

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

The Company adopted the provisions of FASB Interpretation (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 of liabilities for unrecognized tax benefit, which are related to the temporary difference arising from the timing of expensing certain inventories. Such liabilities were accounted for as an increase to the January 1, 2007 balance of accumulated deficits. As of June 29, 2008 and July 1, 2007, the Company recorded $1,620 thousand and $1,625 thousand of liabilities for unrecognized tax benefits, respectively.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax expenses. The Company recognized $37 thousand and $76 thousand of interest and penalties as income tax expenses for the three and six months ended June 29, 2008, respectively. And it also recognized $40 thousand and $80 thousand of interest and penalties as income tax expenses for the three and six months ended July 1, 2007, respectively. Total interest and penalties accrued as of June 29, 2008, July 1, 2007 and as of the FIN No. 48 adoption date were $696 thousand, $622 thousand and $530 thousand, respectively.

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, Semiconductor Manufacturing Services and Power Solutions, 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. The Power Solutions segment s primary products are MOSFETs, analog switches, DC-DC converters and linear regulators. 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 Relate 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	
	June 29, 2008	July 1, 2007
Net Sales		
Display Solutions	$ 83,663	$ 85,113
Imaging Solutions	20,888	17,371
Semiconductor Manufacturing Services	86,711	75,086
Power Solutions	2,091	
All other	1,323	16,483
Total segment net sales	$ 194,676	$ 194,053
Gross Profit (Loss)		
Display Solutions	$ 19,048	$ 8,136
Imaging Solutions	(1,893)	1,272
Semiconductor Manufacturing Services	30,463	11,716
Power Solutions	366	
All other	1,170	6,630
Total segment gross profit	$ 49,154	$ 27,754

	Six months ended	
	June 29, 2008	July 1, 2007
Net Sales		
Display Solutions	$ 177,623	$ 143,983
Imaging Solutions	45,210	29,143
Semiconductor Manufacturing Services	169,538	132,841
Power Solutions	2,091	
All other	3,266	39,869

Total segment net sales	$ 397,728	$ 345,836
Gross Profit (Loss)		
Display Solutions	$ 38,516	$ 15,225
Imaging Solutions	(971)	(148)
Semiconductor Manufacturing Services	57,098	14,563
Power Solutions	362	
All other	2,015	13,037
Total segment gross profit	$ 97,020	$ 42,677

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

As of June 29, 2008, approximately 98% of the Company s property, plant and equipment were located in Korea.

Net sales from the Company s ten largest customers accounted for 58.9% and 63.1% for the three months ended June 29, 2008 and July 1, 2007, respectively, and 59.6% and 65.6% for the six months ended June 29, 2008 and July 1, 2007, respectively.

The Company recorded $45.0 million and $52.6 million of sales to one customer within the Display Solutions segment, which represents greater than 10% of net sales, for the three months ended June 29, 2008 and July 1, 2007, respectively, and $91.1 million and $95.4 million for the six months ended June 29, 2008 and July 1, 2007, respectively.

13. Commitments and Contingencies

Advisory agreements were entered into as of October 6, 2004 by and between the Company and each of the advisors including Court Square Advisor, LLC (successor in interest to CVC Management LLC) (Court Square), CVC Capital Partners Asia Limited (CVC Capital) and Francisco Partners Management LLC (Francisco Partners). The Company was to pay each of Court Square and Francisco Partners an annual advisory fee the amount of which shall be the greater of $1,379,163 per annum or 0.14777% per annum of annual consolidated revenue, and is also to pay CVC Capital an annual advisory fee the amount of which shall be the greater of $741,673 per annum or 0.07946% per annum of annual consolidated revenue plus reasonable out-of-pocket expenses for an initial term of 10 years (subsequently extended for an additional year), subject to termination by either party upon written notice 90 days prior to the expiration of the initial term or any extension thereof. During the year ended December 31, 2005 and the three-month period ended December 31, 2004, the Company accrued $3,545 thousand and $890 thousand of accrued expenses under these agreements, respectively. During the year ended December 31, 2006, due to lower financial performances, the advisors agreed to waive the advisory fee and, therefore, the Company did not accrue any expenses. Effective June 30, 2007, the parties to the advisory agreements entered into that certain First Amendment to Advisory Agreement (the Amendment) under which all rights and obligations of the parties terminate except for indemnity and liability provisions. The Amendment provides that upon a sale of the Company to an unaffiliated third party or a firmly underwritten public offering of common equity of the Company with net proceeds of $50 million or more, the Company must pay a termination fee to the advisors in the amount of all advisory fees not paid under the advisory agreements plus the net present value of all advisory fees that would have been payable through October 6, 2014 had the advisory agreements not been amended. The amount of the termination fee will be determined through discussions between the parties to the advisory agreements, and the Company currently expects the termination fee will be approximately $9.8 million.

The Company has made a contingent commitment to its employees that it will pay an incentive of approximately $30 million in total. This incentive payment is subject to management s discretion and would be distributed to all employees, other than senior management, who are employed by the Company at the closing date of the Company s initial public offering.

14. Condensed Consolidating Financial Statements

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

Below are condensed consolidating balance sheets as of June 29, 2008 and December 31, 2007, condensed consolidating statements of operations for the three months and six months ended June 29, 2008 and July 1, 2007 and condensed consolidating statement of cash flows for the six months ended June 29, 2008 and July 1, 2007 of those entities that guarantee the Senior Subordinated Notes, those that do not, MagnaChip Semiconductor LLC, and the co-issuers.

18

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 June 29, 2008

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 189,599	$ 102,170	$ (97,093)	$ 194,676
Cost of sales			144,768	88,675	(87,921)	145,522
Gross profit			44,831	13,495	(9,172)	49,154
Selling, general and administrative expenses	93	212	19,065	3,801	(161)	23,010
Research and development expenses			36,345	8,121	(8,972)	35,494
Operating income (loss)	(93)	(212)	(10,579)	1,573	(39)	(9,350)
Other income (expenses)		(2,979)	(46,708)	2,722		(46,965)
Income (loss) before income taxes, equity in earnings (loss) of related equity investment	(93)	(3,191)	(57,287)	4,295	(39)	(56,315)
Income tax expenses		561	37	2,680		3,278
Loss before equity in loss of related investment	(93)	(3,752)	(57,324)	1,615	(39)	(59,593)
Loss of related investment	(59,500)	(55,963)		(56,817)	172,280	
Net loss	$ (59,593)	$ (59,715)	$ (57,324)	$ (55,202)	$ 172,241	$ (59,593)
Dividends accrued on preferred units	3,281					3,281
Net loss attributable to common units	$ (62,874)	$ (59,715)	$ (57,324)	$ (55,202)	$ 172,241	$ (62,874)

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the six months ended June 29, 2008

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 382,977	$ 207,485	$ (192,734)	$ 397,728
Cost of sales			295,857	180,445	(175,594)	300,708
Gross profit			87,120	27,040	(17,140)	97,020
Selling, general and administrative expenses	213	694	34,425	7,263	(361)	42,234
Research and development expenses			73,191	15,925	(17,275)	71,841
Restructuring and impairment charge			(875)			(875)
Operating income (loss)	(213)	(694)	(19,621)	3,852	496	(16,180)
Other income (expenses)		9,553	(101,758)	(13,319)		(105,524)
Income (loss) before income taxes, equity in earnings (loss) of related equity investment	(213)	8,859	(121,379)	(9,467)	496	(121,704)
Income tax expenses		604	81	5,101		5,786
Income (loss) before equity in loss of related investment	(213)	8,255	(121,460)	(14,568)	496	(127,490)
Loss of related investment	(127,277)	(136,072)		(120,161)	383,510	
Net loss	$ (127,490)	$ (127,817)	$ (121,460)	$ (134,729)	$ 384,006	$ (127,490)
Dividends accrued on preferred units	6,399					6,399
Net loss attributable to common units	$ (133,889)	$ (127,817)	$ (121,460)	$ (134,729)	$ 384,006	$ (133,889)

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the three months ended July 1, 2007

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

21

Table of Contents

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the six months ended July 1, 2007

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 335,257	$ 137,099	$ (126,520)	$ 345,836
Cost of sales						