

MAGNACHIP SEMICONDUCTOR LLC

Form 10-Q

August 13, 2008

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

(Mark one)

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

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**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  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  (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

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

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MagnaChip Semiconductor LLC and Subsidiaries

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

	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)**

	<b>June 29, 2008</b>	<b>December 31, 2007</b>
<b>Assets</b>		
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
<b>Liabilities and Unitholders Equity</b>		
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
<b>Commitments and contingencies</b>		
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
<b>Unitholders equity</b>		
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)

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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*

**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				
<b>Three months ended June 29, 2008</b>						
<b>Balance at March 30, 2008</b>	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
<b>Total comprehensive loss</b>						<b>(44,117)</b>
<b>Balance at June 29, 2008</b>	52,919,108	\$ 52,919	\$ 2,900	\$ (698,338)	\$ 67,068	\$ (575,451)
<b>Six months ended June 29, 2008</b>						
<b>Balance at January 1, 2008</b>	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
<b>Total comprehensive loss</b>						<b>(91,471)</b>
<b>Balance at June 29, 2008</b>	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				
<b>Three months ended July 1, 2007</b>						
<b>Balance at April 1, 2007</b>	52,720,784	\$ 52,721	\$ 2,476	\$ (441,720)	\$ 31,538	\$ (354,985)
Exercise of unit options	80,000	80				80
Unit-based compensation			45			45
Dividends accrued on preferred units				(2,983)		(2,983)
Comprehensive income (loss):						
Net loss				(45,324)		(45,324)
Fair valuation of derivatives					(17)	(17)
Foreign currency translation adjustments					(5,378)	(5,378)
Total comprehensive loss						(50,719)
<b>Balance at July 1, 2007</b>	52,800,784	\$ 52,801	\$ 2,521	\$ (490,027)	\$ 26,143	\$ (408,562)
<b>Six months ended July 1, 2007</b>						
<b>Balance at January 1, 2007</b>	52,720,784	\$ 52,721	\$ 2,451	\$ (370,314)	\$ 30,601	\$ (284,541)
Exercise of unit options	80,000	80				80
Unit-based compensation			70			70
Dividends accrued on preferred units				(5,853)		(5,853)
Retained earnings carried over from prior year (FIN 48)				(1,554)		(1,554)
Comprehensive income (loss):						
Net loss				(112,306)		(112,306)
Fair valuation of derivatives					(934)	(934)
Foreign currency translation adjustments					(3,524)	(3,524)
Total comprehensive loss						(116,764)
<b>Balance at July 1, 2007</b>	52,800,784	\$ 52,801	\$ 2,521	\$ (490,027)	\$ 26,143	\$ (408,562)

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



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

	<b>Six months ended</b>	
	<b>June 29, 2008</b>	<b>July 1, 2007</b>
<b>Cash flows from operating activities</b>		
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)
<b>Cash flows from investing activities</b>		
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)
<b>Cash flows from financing activities</b>		
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**

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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*

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**MagnaChip Semiconductor LLC and Subsidiaries**

**Notes to Condensed Consolidated Financial Statements**

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

**1. Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited interim condensed consolidated financial statements of MagnaChip Semiconductor LLC and its subsidiaries (the Company) have been prepared in accordance with Accounting Principle Board (APB) Opinion No. 28, *Interim Financial Reporting* regarding interim financial information and, accordingly, do not include all of the information and note disclosures required by generally accepted accounting principles in the United States of America for complete financial statements. In the opinion of the Company's management, the unaudited interim condensed consolidated financial statements include all normal recurring adjustments necessary to fairly present the information required to be set forth therein. All inter-company accounts and transactions have been eliminated. 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.

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**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:

	<b>June 29, 2008</b>	<b>December 31, 2007</b>
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:

	<b>June 29, 2008</b>	<b>December 31, 2007</b>
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



**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:

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

	<b>Three months ended</b>		<b>Six months ended</b>	
	<b>June 29, 2008</b>	<b>July 1, 2007</b>	<b>June 29, 2008</b>	<b>July 1, 2007</b>
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:

	<b>Severance benefit</b>
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)
Dividends to preferred unitholders	3,281	2,983	6,399	5,853

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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)

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**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:

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

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**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.

**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, 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 Related Information*, allocates resources to and assesses the performance of each segment using information about its revenue and gross profit. The Company does not identify or allocate assets by segments, nor does the CODM evaluate operating segments using discrete asset information. In addition, the Company does not allocate operating expense, interest income or expense, other income or expense, or income tax to the segments. Management does not evaluate segments based on these criteria. The following sets forth information relating to the reportable segments:

	<b>Three months ended</b>	
	<b>June 29, 2008</b>	<b>July 1, 2007</b>
<b>Net Sales</b>		
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
<b>Total segment net sales</b>	<b>\$ 194,676</b>	<b>\$ 194,053</b>

<b>Gross Profit (Loss)</b>		
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
<b>Total segment gross profit</b>	<b>\$ 49,154</b>	<b>\$ 27,754</b>

	<b>Six months ended</b>	
	<b>June 29, 2008</b>	<b>July 1, 2007</b>
<b>Net Sales</b>		
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



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Total segment net sales	\$ 397,728	\$ 345,836
<b>Gross Profit (Loss)</b>		
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

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**Table of Contents**

**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.



**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)	

**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 June 29, 2008**

	<b>MagnaChip Semiconductor LLC (Parent)</b>	<b>Co-Issuers</b>	<b>Non- Guarantors</b>	<b>Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
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)

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

	<b>MagnaChip Semiconductor LLC (Parent)</b>	<b>Co-Issuers</b>	<b>Non- Guarantors</b>	<b>Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
Net sales	\$	\$	\$ 188,651	\$ 80,257	\$ (74,855)	\$ 194,053
Cost of sales			165,326	69,832	(68,859)	166,299
<b>Gross profit</b>			<b>23,325</b>	<b>10,425</b>	<b>(5,996)</b>	<b>27,754</b>
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
<b>Operating income (loss)</b>	<b>(189)</b>	<b>(229)</b>	<b>(43,442)</b>	<b>1,513</b>	<b>(48)</b>	<b>(42,395)</b>
Other income (expenses)		(1,524)	(27)	467		(1,084)
<b>Income (loss) before income taxes, equity in earning (loss) of related equity investment</b>	<b>(189)</b>	<b>(1,753)</b>	<b>(43,469)</b>	<b>1,980</b>	<b>(48)</b>	<b>(43,479)</b>
Income tax expenses		42	1	1,802		1,845
<b>Loss before equity in loss of related investment</b>	<b>(189)</b>	<b>(1,795)</b>	<b>(43,470)</b>	<b>178</b>	<b>(48)</b>	<b>(45,324)</b>
Loss of related investment	(45,135)	(43,557)		(43,079)	131,771	
<b>Net loss</b>	<b>\$ (45,324)</b>	<b>\$ (45,352)</b>	<b>\$ (43,470)</b>	<b>\$ (42,901)</b>	<b>\$ 131,723</b>	<b>\$ (45,324)</b>
Dividends accrued on preferred units		2,983				2,983
<b>Net loss attributable to common units</b>	<b>\$ (48,307)</b>	<b>\$ (45,352)</b>	<b>\$ (43,470)</b>	<b>\$ (42,901)</b>	<b>\$ 131,723</b>	<b>\$ (48,307)</b>

**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**

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

**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****June 29, 2008**

	<b>MagnaChip Semiconductor LLC (Parent)</b>	<b>Co-Issuers</b>	<b>Non- Guarantors</b>	<b>Guarantors</b>	<b>Eliminations</b>	<b>Consolidated</b>
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$ 238	\$ 5,373	\$ 27,443	\$ 3,449	\$	\$ 36,503
Accounts receivable, net			158,193	91,595	(100,576)	149,212
Inventories, net			62,744	953	(165)	63,532
Other receivables		718	8,267	6,464	(9,969)	5,480
Short-term inter-company loans		80,000		80,000	(160,000)	
Other current assets	3,151	3,755	14,233	6,804	(10,485)	17,458
<b>Total current assets</b>	<b>3,389</b>	<b>89,846</b>	<b>270,880</b>	<b>189,265</b>	<b>(281,195)</b>	<b>272,185</b>
Property, plant and equipment, net			241,161	5,078		246,239
Intangible assets, net			64,866	17,361	(148)	82,079
Investments in subsidiaries	(439,392)	(530,633)		(327,318)	1,297,343	
Long-term inter-company loans		824,512		635,544	(1,460,056)	
Other non-current assets		12,391	41,098	9,512	(18,221)	44,780
<b>Total assets</b>	<b>(436,003)</b>	<b>396,116</b>	<b>618,005</b>	<b>529,442</b>	<b>(462,277)</b>	<b>645,283</b>
<b>Liabilities and Unitholders equity</b>						
Current liabilities						
Accounts payable	\$	\$	\$ 140,615	\$ 78,019	\$ (100,576)	\$ 118,058
Other accounts payable	3,624	5	28,483	2,131	(9,969)	24,274
Accrued expenses	20	3,045	18,624	5,846	(7,263)	20,272
Short-term Borrowings		85,000	80,000	80,000	(160,000)	85,000
Other current liabilities		549	1,470	4,961	(3,222)	3,758
<b>Total current liabilities</b>	<b>3,644</b>	<b>88,599</b>	<b>269,192</b>	<b>170,957</b>	<b>(281,030)</b>	<b>251,362</b>
Long-term borrowings		750,000	621,000	839,056	(1,460,056)	750,000
Accrued severance benefits, net			69,999	616		70,615
Other non-current liabilities			11,479	19,695	(18,221)	12,953
<b>Total liabilities</b>	<b>3,644</b>	<b>838,599</b>	<b>971,670</b>	<b>1,030,324</b>	<b>(1,759,307)</b>	<b>1,084,930</b>
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred units	135,804					135,804



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Total redeemable convertible preferred units	135,804					135,804
Unitholders' equity						
Common units	52,919	136,229	39,005	55,778	(231,012)	52,919
Additional paid-in capital	2,900	2,066	156,044	108,164	(266,274)	2,900
Accumulated deficit	(698,338)	(648,598)	(613,405)	(736,128)	1,998,131	(698,338)
Accumulated other comprehensive income	67,068	67,820	64,691	71,304	(203,815)	67,068
Total unitholders' equity	(575,451)	(442,483)	(353,665)	(500,882)	1,297,030	(575,451)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ (436,003)	\$ 396,116	\$ 618,005	\$ 529,442	\$ (462,277)	\$ 645,283

**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, 2007**

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Assets</b>						
Current assets						
Cash and cash equivalents	\$ 163	\$ 31,248	\$ 24,301	\$ 8,633	\$	\$ 64,345
Accounts receivable, net			131,101	68,156	(75,468)	123,789
Inventories, net			71,930	4,598	(661)	75,867
Other receivables		717	5,846	12,702	(13,494)	5,771
Short-term inter-company loan		50,000		50,000	(100,000)	
Other current assets	1,129	9,037	9,309	6,047	(14,571)	10,951
<b>Total current assets</b>	<b>1,292</b>	<b>91,002</b>	<b>242,487</b>	<b>150,136</b>	<b>(204,194)</b>	<b>280,723</b>
Property, plant and equipment, net			275,997	3,672		279,669
Intangible assets, net			86,571	18,328	(174)	104,725
Investments in subsidiaries	(348,345)	(431,611)		(243,130)	1,023,086	
Long-term inter-company loans		809,754		634,837	(1,444,591)	
Other non-current assets		13,897	38,866	9,823	(19,820)	42,766
<b>Total assets</b>	<b>\$ (347,053)</b>	<b>\$ 483,042</b>	<b>\$ 643,921</b>	<b>\$ 573,666</b>	<b>\$ (645,693)</b>	<b>\$ 707,883</b>
<b>Liabilities and Unitholders equity</b>						
Current liabilities						
Accounts payable	\$	\$	\$ 101,056	\$ 64,389	\$ (75,468)	\$ 89,977
Other accounts payable	1,021	5	40,381	2,748	(13,494)	30,661
Accrued expenses		3,389	16,412	9,647	(11,348)	18,100
Short-term borrowings		80,000	50,000	50,000	(100,000)	80,000
Other current liabilities		503	3,714	5,383	(3,223)	6,377
<b>Total current liabilities</b>	<b>1,021</b>	<b>83,897</b>	<b>211,563</b>	<b>132,167</b>	<b>(203,533)</b>	<b>225,115</b>
Long-term borrowings		750,000	621,000	823,591	(1,444,591)	750,000
Accrued severance benefits, net			73,700	476		74,176
Other non-current liabilities			4,867	21,619	(19,820)	6,666
<b>Total liabilities</b>	<b>1,021</b>	<b>833,897</b>	<b>911,130</b>	<b>977,853</b>	<b>(1,667,944)</b>	<b>1,055,957</b>
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred unites	129,405					129,405

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Total redeemable convertible preferred units	129,405					129,405
Unitholders' equity						
Common units	52,844	136,229	39,005	55,778	(231,012)	52,844
Additional paid-in capital	3,077	1,899	155,888	107,946	(265,733)	3,077
Accumulated deficit	(564,449)	(520,781)	(491,945)	(601,399)	1,614,125	(564,449)
Accumulated other comprehensive income	31,049	31,798	29,843	33,488	(95,129)	31,049
Total unitholders' equity	(477,479)	(350,855)	(267,209)	(404,187)	1,022,251	(477,479)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ (347,053)	\$ 483,042	\$ 643,921	\$ 573,666	\$ (645,693)	\$ 707,883

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****Condensed Consolidating Statement of Cash Flows****For the six months ended June 29, 2008**

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Cash flow from operating activities:</b>						
Net loss	\$ (127,490)	\$ (127,817)	\$ (121,460)	\$ (134,729)	\$ 384,006	\$ (127,490)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			40,040	1,842		41,882
Provision for severance benefits			6,772	118		6,890
Amortization of debt issuance costs		1,506	482			1,988
(Gain) loss on foreign currency translation, net		(14,758)	72,435	15,401		73,078
Loss (gain) on disposal of property, plant and equipment, net			(3,472)	1		(3,471)
Loss of related investment	127,277	136,072		120,161	(383,510)	
Other	10		503	(127)		386
<b>Changes in operating assets and liabilities:</b>						
Accounts receivable			(40,986)	(21,060)	25,108	(36,938)
Inventories			1,891	3,750	(499)	5,142
Other receivables			(2,816)	6,267	(3,525)	(74)
Deferred tax assets				854		854
Accounts payable			44,254	11,681	(25,108)	30,827
Other accounts payable	2,604		(11,465)	(669)	3,525	(6,005)
Accrued expenses	20	(344)	3,727	(3,830)	4,085	3,658
Other current assets	(2,022)	4,292	3,950	(578)	(5,712)	(70)
Other current liabilities		46	(2,042)	(521)	1,681	(836)
Payment of severance benefits			(2,794)			(2,794)
Other		128	(2,237)	(2,980)	3,132	(1,957)
Net cash provided by (used in) operating activities	399	(875)	(13,218)	(4,419)	3,183	(14,930)
<b>Cash flows from investing activities:</b>						
Purchase of plant, property and equipment			(18,800)	(1,666)		(20,466)
Payment for intellectual property registration			(479)	(246)		(725)
Proceeds from disposal of property, plant and equipment			3,472	1		3,473
Other		(30,000)	(132)	(30,085)	60,000	(217)
Net cash used in investing activities		(30,000)	(15,939)	(31,996)	60,000	(17,935)
<b>Cash flows from financing activities:</b>						
Issuance of common stock	172					172

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Repurchase of common stock	(496)					(496)
Repayment of short-term borrowings		(150,000)	(100,000)	(100,000)	200,000	(150,000)
Proceeds from short-term borrowings		155,000	130,000	130,000	(260,000)	155,000
Net cash provided by (used in) financing activities	(324)	5,000	30,000	30,000	(60,000)	4,676
Effect of exchange rates on cash and cash equivalents			2,299	1,231	(3,183)	347
Net increase (decrease) in cash and cash equivalents	75	(25,875)	3,142	(5,184)		(27,842)
<b>Cash and cash equivalents:</b>						
Beginning of the period	163	31,248	24,301	8,633		64,345
End of the period	\$ 238	\$ 5,373	\$ 27,443	\$ 3,449	\$	\$ 36,503

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

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

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

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the federal securities laws that involve risks and uncertainties. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify these statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as anticipate, estimate, expect, project, intend, plan, believe and other words and terms of similar meaning in connection with any discussion of the time nature of future operating or financial performance or other events. All statements other than statements of historical facts included in this report that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements.

These forward-looking statements are largely based on our expectations and beliefs concerning future events, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Although we believe our estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management's assumptions about future events may prove to be inaccurate. Management cautions all readers that the forward-looking statements contained in this report are not guarantees of future performance, and we cannot assure any reader that those statements will be realized or the forward-looking events and circumstances will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to the factors listed in this section and the Risk Factors and elsewhere in this report.

All forward-looking statements speak only as of the date of this report. We do not intend to publicly update or revise any forward-looking statements as a result of new information or future events or otherwise, except as required by law. These cautionary statements qualify all forward-looking statements attributable to us or persons acting on our behalf.

**Overview**

We are a Korea-based designer and manufacturer of analog and mixed-signal semiconductor products for high volume consumer applications, such as mobile phones, digital televisions, flat panel displays, notebook computers, mobile multimedia devices and digital cameras. Our analog and mixed-signal semiconductor products and services enable the high resolution display of images and video, conversion of analog signals, such as light and sound, into digital data as well as manage power consumption. Our display driver solutions cover a wide range of display sizes used in high definition liquid crystal display, or LCD, televisions, flat panel displays, notebook computers and mobile communications and entertainment devices. Our image sensor solutions are highly integrated and designed to provide brighter, sharper and more colorful image quality in a variety of light conditions for use primarily in mobile handset, PC and notebook computer camera applications and security systems. We have also utilized our technology platform and manufacturing process expertise to design power management solutions in order to expand our market opportunity and address more of our customers' needs. We offer semiconductor manufacturing services to providers of analog and mixed-signal semiconductors that require differentiated, specialty process technologies such as high voltage CMOS, embedded memory and power management.

The variety of analog and mixed-signal semiconductor products and services we offer is based on a technology platform and strategy that allows us to address multiple end markets and to develop and introduce new products quickly. We believe that our manufacturing integration and broad intellectual property enable us to respond quickly to our consumer electronics and semiconductor customers' needs. To maintain and increase our profitability, we must forecast trends in consumer product demand and invest in relevant research and development activities and in appropriate capital equipment. We expect to maintain or increase our expenditures on research and development in future periods to establish our position as a leading provider of semiconductor products and services in the segments in which we compete.

The semiconductor markets in which we compete are characterized by the use of advanced production technology and rapid technological advances. The prices of our products tend to decrease regularly over their useful lives, and such price decreases can be significant as new generations of products are introduced. We manage our pricing, production and product development activities so as to benefit from, or at least mitigate any adverse impact of, declining market prices for our products. For example, in some periods we are able to offset the impact of declining selling prices for existing products through the introduction of new products that command selling prices above the average selling price of our existing products. In addition, we seek to manage our inventories and manufacturing capacity so as to preclude losses from inevitable product and productive capacity obsolescence.





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Demand for our products and services is driven primarily by overall demand for the consumer end products in which our products are used and, consequently, can be adversely affected by periods of weak consumer spending in developed countries. Nonetheless, the consumer electronics market is large and rapidly growing, driven by consumers seeking to enjoy rich media content, such as digital and high definition audio and video, mobile television, games and digital photography. As a company, we seek to address market segments with higher growth rates than the overall consumer electronics industry. In recent years, we have experienced increasing demand from OEMs and consumers in developing countries such as China and India, and we expect to derive a substantial portion of our growth in the next decade from growing demand in such markets. We also expect that new competitors will emerge in these markets that may place increased pressure on the pricing for our products and services, but we believe that the competitive offerings will be, at least initially, of lower quality than the products and services that we offer, and that the impact from the increased competition will be more than offset by demand arising from such markets. Further, we believe we are well-positioned geographically to capture this demand, with our Korea-based operations.

Within particular operating segments and products, net sales are driven by design wins in which we or another company is selected by an electronics OEM or other potential customer to supply its demand of a particular product. These competitions typically determine the semiconductor supplier for the life of a particular end product and specify in many cases the production volume and pricing of a particular semiconductor product throughout the life of the end product. In any given period, our net sales depend heavily upon the end-market demand for the goods in which our products are used and the inventory levels maintained by our customers.

Our products and services require investments in capital equipment. We focus on specialty technologies, however, that do not require investments in leading edge manufacturing equipment, and as a result, our business tends not to be as subject to the pronounced boom and bust cycles characteristic of other semiconductor markets, in which the introduction of substantial, high-fixed cost capacity can cause product prices to plunge dramatically. In general, we seek to invest in manufacturing capacity that can be used for multiple high-value applications over an extended period of time. We believe this capital investment strategy enables us to optimize our capital investments and facilitates deeper and more diversified product and service offerings.

Our success going forward will depend upon our ability to adapt to future challenges such as the emergence of new competitors for our products and services or the consolidation of current competitors. Additionally, we must innovate to remain ahead of, or at least rapidly adapt to, technological breakthroughs that may lead to a step function change in the technology necessary to deliver our products and services. We believe that our established relationships and close collaboration with leading customers, such as LG Display (formerly LG.Philips LCD), Sharp, and Samsung, enhance our visibility into new product opportunities, market and technology trends and improve our ability to meet these challenges successfully.

## ***Business Segments***

We report in four separate business segments because we derive our revenues from four principal business lines: Display Solutions, Imaging Solutions, Semiconductor Manufacturing Services, and Power Solutions. We have identified these segments based on how we allocate resources and assess our performance.

*Display Solutions:* Our Display Solutions segment offers flat panel display drivers for a wide range of small to large panel displays used in digital televisions, mobile phones, LCD monitors, notebook computers and mobile multimedia devices, such as handheld games. Our products cover a broad range of interfaces, packages and technologies, including AMOLED, LTPS and TFT technologies.

*Imaging Solutions:* Our Imaging Solutions segment covers a broad spectrum of videographics array, or VGA; 1.3, 2.1 and 3.2 megapixel, or MP; CMOS image sensors for large and rapidly growing camera-equipped applications, such as mobile handsets, PCs, digital cameras, notebook computers and security cameras. Our image sensors are designed to provide brighter, sharper and more colorful image quality for use primarily in applications that require a small form factor, low power consumption and high sensitivity in a variety of light conditions.

*Semiconductor Manufacturing Services:* Our Semiconductor Manufacturing Services segment manufactures wafers for analog and mixed-signal semiconductor companies based on their designs. The activities conducted within this segment are, in substance, identical to those conducted in our Display Solution and Imaging Solution businesses. The only difference is that, in the Semiconductor Manufacturing Services segment, the product designs originate from our customers. The customers provide us with

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their designs, and we manufacture and sell the products to the customers based upon such designs. We offer over 180 process flows to our manufacturing services customers. We also often partner with key customers to jointly develop or customize specialized processes that enable our customers to improve their products and allow us to develop unique manufacturing expertise. Our manufacturing services offering is targeted at customers who require differentiated, specialty analog and mixed-signal process technologies such as high voltage CMOS, embedded memory and power. These customers typically serve high growth and high volume applications in the consumer, computing, wireless and industrial end markets.

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*Power Solutions:* Our Power Solutions segment produces MOSFETs, analog switches, DC-DC converters and linear regulators, such as LDOs. Our power solutions products are designed for applications such as mobile phones, LCD televisions, and desktop computers, and allow electronics manufacturers to achieve specific design goals of high efficiency and low standby power consumption. Going forward, we expect to expand our power management product portfolio through the addition, for example, of more advanced DC-DC products.

**Results of Operations**

The following table sets forth consolidated results of operations for the three months ended June 29, 2008 and July 1, 2007:

	Three months ended June 29, 2008		Three months ended July 1, 2007		Change Amount
	Amount	% of net sales	Amount <i>(in millions; %)</i>	% of net sales	
Net sales	\$ 194.7	100.0%	\$ 194.1	100.0%	\$ 0.6
Cost of sales	145.5	74.8	166.3	85.7	(20.8)
Gross profit	49.2	25.2	27.8	14.3	21.4
Selling, general and administrative expenses	23.0	11.8	25.5	13.2	(2.5)
Research and development expenses	35.5	18.2	32.5	16.8	3.0
Restructuring and impairment charges			12.1	6.2	(12.1)
Operating loss	(9.4)	(4.8)	(42.4)	(21.8)	33.0
Interest expense, net	15.8	8.1	15.0	7.7	0.9
Foreign currency gain (loss), net	(31.1)	(16.0)	13.9	7.1	(45.0)
Loss before income taxes	(56.3)	(28.9)	(43.5)	(22.4)	(12.8)
Income tax expenses	3.3	1.7	1.8	1.0	1.4
Net loss	\$ (59.6)	(30.6)%	\$ (45.3)	(23.4)%	\$ (14.3)

**Net Sales**

	Three months ended June 29, 2008		Three months ended July 1, 2007		Change Amount
	Amount	% of Total	Amount <i>(in millions; %)</i>	% of Total	
Display Solutions	\$ 83.7	43.0%	\$ 85.1	43.9%	\$ (1.5)
Imaging Solutions	20.9	10.7	17.4	9.0	3.5
Semiconductor Manufacturing Services	86.7	44.5	75.1	38.7	11.6
Power Solutions	2.1	1.1			2.1
All other	1.3	0.7	16.5	8.5	(15.2)
	\$ 194.7	100.0%	\$ 194.1	100.0%	\$ 0.6

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

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Total net sales for the three months ended June 29, 2008 increased \$0.6 million, or 0.3% compared to the three months ended July 1, 2007. Net sales generated in the four operating segments during the current quarter were \$193.4 million, an increase of \$15.8 million or 8.9% from the net sales of the three operating segments from which we earned revenues for the prior-year quarter. We achieved this result even though demand was lower than expected as our customers tightened their inventory control due to the current uncertain economic environment. Importantly, we continued to add new accounts and to offer new products and services that we expect to contribute to revenue growth in future quarters.

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*Display Solutions.* Net sales from Display Solutions for the three months ended June 29, 2008 were \$83.7 million, a \$1.5 million or 1.7% decrease from \$85.1 million for the three months ended July 1, 2007. The decrease resulted from a 12.0% decrease in average selling prices, primarily from display driver products for LCD televisions and PC monitors, coupled with a 5.1% sales volume decrease. We expect that strong demand for display driver interfaces that manage power consumption efficiently as well as for high-resolution and feature-rich display drivers will contribute positively to the results of our Display Solutions segment in future quarters.

*Imaging Solutions.* Net sales from Imaging Solutions increased \$3.5 million in the current quarter, or 20.2% compared to net sales generated in the prior year quarter. This increase resulted from a 39.2% sales volume increase mainly driven by small form factor VGA products, and was partially offset by a 13.4% decrease in average selling prices.

*Semiconductor Manufacturing Services.* Net sales from Semiconductor Manufacturing Services for the second quarter of 2008 were \$86.7 million, an \$11.6 million or 15.5% increase compared to net sales of \$75.1 million for the prior year quarter. This increase was primarily due to a 19.7% sales volume increase and was partially offset by a 5.5% decrease in average selling prices. We expect the results for our Semiconductor Manufacturing Services segment to remain stable or grow in the remainder of 2008.

*Power Solutions.* Net sales from Power Solutions for the second quarter of 2008 were \$2.1 million. We shipped our first products and recorded our first sales revenue in the quarter. We have built our new product pipeline with the launch of our 30V and 40V MOSFET series and development of LDO and USB solutions. We expect revenues from our Power Solutions segment to grow in the remainder of 2008.

*All other.* Net sales from All other for the three months ended June 29, 2008 were \$1.3 million compared to \$16.5 million for the three months ended July 1, 2007. This decrease of \$15.2 million was primarily due to a \$14.9 million decrease in unit processing services rendered to Hynix as Hynix increased its internal capacity. We rendered no unit processing services to Hynix during the three months ended June 29, 2008.

**Net Sales by Geographic Region**

The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the three months ended June 29, 2008 and July 1, 2007, respectively:

	Three months ended June 29, 2008		Three months ended July 1, 2007	
	Amount	% of Total	Amount	% of Total
	<i>(in millions; %)</i>			
Korea	\$ 100.1	51.4%	\$ 117.4	60.5%
Asia Pacific	51.0	26.2	43.7	22.5
Japan	22.4	11.5	15.4	8.0
North America	16.7	8.6	13.0	6.7
Europe	4.5	2.3	4.5	2.3
Total net revenues	\$ 194.7	100.0%	\$ 194.1	100.0%

**Gross Profit**

	Three months ended June 29, 2008		Three months ended July 1, 2007		Change Amount
	Amount	% of net sales	Amount	% of net sales	
	<i>(in millions; %)</i>				
Display Solutions	\$ 19.0	22.8%	\$ 8.1	9.6%	\$ 10.9
Imaging Solutions	(1.9)	(9.1)	1.3	7.3	(3.2)
Semiconductor Manufacturing Services	30.5	35.1	11.7	15.6	18.7
Power Solutions	0.4	17.5			0.4
All other	1.2	88.4	6.6	40.2	(5.5)

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\$ 49.2	25.2%	\$ 27.8	14.3%	\$ 21.4
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Total gross profit increased \$21.4 million in the second quarter of 2008, or 77.1%, compared to the gross profit generated in the prior-year quarter. Gross profit percentage for the current quarter was 25.2% of net sales, an increase of 10.9% from 14.3% for the prior-year quarter. This increase in gross profit percentage was primarily attributable to an overall decrease in unit costs due to an increase in overall production volume and a decrease in depreciation expense. We expect our gross profit to benefit in the next several quarters from the sale of inventory reflecting our reduced cost structure as well as due to increased capacity utilization.

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*Display Solutions.* Gross profit percentage for Display Solutions for the three months ended June 29, 2008 improved to 22.8% compared to 9.6% for the three months ended July 1, 2007 due to a decrease in unit costs that resulted from an increase in overall production volume.

*Imaging Solutions.* Gross profit percentage for Imaging Solutions decreased to minus 9.1% in the second quarter ended June 29, 2008 compared to 7.3% of positive gross profit percentage for the three months ended July 1, 2008. This change was primarily due to a 13.4% decrease in average selling prices.

*Semiconductor Manufacturing Services.* Gross profit percentage for Semiconductor Manufacturing Services improved to 35.1% in the second quarter of 2008 from 15.6% in the prior-year quarter. This increase was due to a 19.7% increase in sales volume and a decrease in unit costs, resulting from an increase in overall production volume.

*Power Solutions.* Gross profit percentage for Power Solutions was 17.5% for the three months ended June 29, 2008.

*All other.* Gross profit percentage for All other for the current period increased to 88.4% from 40.2% in the second quarter of 2007. This improvement in gross profit percentage was mainly attributable to lower fixed cost per unit.

**Operating Expenses**

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$23.0 million or 11.8% of net sales for the three months ended June 29, 2008, compared to \$25.5 million or 13.2% for the three months ended July 1, 2007. The decrease of \$2.5 million or 9.9% from the prior-year quarter was from various expenses including outside service fees, depreciation and amortization, sales commissions, and miscellaneous expenses.

*Research and Development Expenses.* Research and development expenses for the current quarter were \$35.5 million, an increase of \$3.0 million or 9.1% from \$32.5 million for the prior year quarter. This increase in research and development expenses essentially represented our focus on the introduction of new products, especially in the Imaging Solutions and Display Solutions segments. As a percentage of net sales, research and development expenses for the current quarter increased to 18.2% compared to 16.8% for the prior-year quarter. We expect research and development expenses in 2008 to be generally consistent with the levels in 2007 on a percentage of net sales basis.

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

**Other Income (Expense)**

*Interest Expense, Net.* Net interest expense was \$15.8 million during the three months ended June 29, 2008 compared to \$15.0 million for the three months ended July 1, 2007. Interest expense was incurred to service to our notes in the amount of \$750.0 million and drawings under our senior secured facility. At June 29, 2008, the notes bore interest at a weighted average interest rate of 7.28%. Drawings under our senior secured credit facility bore interest at June 29, 2008 at either three-month LIBOR plus 4.75% or ABR plus 3.75%. The increase in net interest expense was mainly due to an increase in interest expense driven by drawdowns from our senior secured credit facility and a decrease in interest income from financial assets including cash and cash equivalents.

*Foreign Currency Gain (Loss), Net.* Net foreign currency loss for the three months ended June 29, 2008 was \$31.1 million, compared to net foreign exchange gain of \$13.9 million for the three months ended July 1, 2007.

A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss recorded for intercompany borrowings at our Korean subsidiary and is affected by changes in the exchange rate between the Korea won and the U.S. dollar. Foreign currency translation loss from the intercompany borrowings was included in determining our consolidated net income since the intercompany borrowings were not considered long-term investments in nature because management intended to repay these intercompany borrowings at their maturity dates. The Korean won to U.S. dollar exchange rates were 1,041.8:1 and 922.6:1 using the noon buying rate in effect as of June 29, 2008 and July 1, 2007, respectively, as quoted by the Federal Reserve Bank of New York.





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***Income Tax Expenses***

*Income Tax Expenses.* Income tax expenses for the three months ended June 29, 2008 were \$3.3 million, compared to \$1.8 million for the three months ended July 1, 2007. Income tax expenses for this period were comprised of \$1.3 million of current income taxes incurred in various jurisdictions in which we operate, \$1.5 million of withholding taxes mostly paid on intercompany interest payments and \$0.5 million of income tax increase effect from the change of deferred tax assets. Due to the uncertainty of the utilization of foreign tax credits, we did not recognize these withholding taxes as deferred assets

**Table of Contents****Results of Operations Comparison of Six-Month Periods Ended June 29, 2008 and July 1, 2007.**

The following table sets forth consolidated result of operations for the six months ended June 29, 2008 and July 1, 2007:

	Six months ended June 29, 2008		Six months ended July 1, 2007		Change Amount
	Amount	% of net sales	Amount <i>(in millions; %)</i>	% of net sales	
Net sales	\$ 397.7	100.0%	\$ 345.8	100.0%	\$ 51.9
Cost of sales	300.7	75.6	303.2	87.7	(2.5)
Gross profit	97.0	24.4	42.7	12.3	54.3
Selling, general and administrative expenses	42.2	10.6	48.3	14.0	(6.0)
Research and development expenses	71.8	18.1	67.7	19.6	4.2
Restructuring and impairment charges	(0.9)	(0.2)	12.1	3.5	(13.0)
Operating loss	(16.2)	(4.1)	(85.3)	(24.7)	69.1
Interest expense, net	31.5	7.9	29.4	8.5	2.1
Foreign currency gain (loss), net	(74.0)	(18.6)	6.5	1.9	(80.5)
Loss before income taxes	(121.7)	(30.6)	(108.2)	(31.3)	(13.5)
Income tax expenses	5.8	1.5	4.1	1.2	1.7
Net loss	\$ (127.5)	(32.1)%	\$ (112.3)	(32.5)	\$ (15.2)

**Net Sales**

	Six months ended June 29, 2008		Six months ended July 1, 2007		Change Amount
	Amount	% of Total	Amount <i>(in millions; %)</i>	% of total	
Display Solutions	\$ 177.6	44.7%	\$ 144.0	41.6%	\$ 33.6
Imaging Solutions	45.2	11.4	29.1	8.4	16.1
Semiconductor Manufacturing Services	169.5	42.6	132.8	38.4	36.7
Power Solutions	2.1	0.5			2.1
All other	3.3	0.8	39.9	11.5	(36.6)
	\$ 397.7	100.0%	\$ 345.8	100.0%	\$ 51.9

Total net sales for the six months ended June 29, 2008 increased \$51.9 million, or 15.0% compared to the six months ended July 1, 2007. Net sales generated in the four operating segments during the current period were \$394.5 million, an increase of \$88.5 million or 28.9% from the net sales of the three operating segments from which we earned revenues for the prior-year period.

*Display Solutions.* Net sales from Display Solutions for the six months ended June 29, 2008 were \$177.6 million, a \$33.6 million or 23.4% increase from \$144.0 million for the six months ended July 1, 2007. This increase resulted from a 25.6% sales volume increase, primarily from display driver products for LCD televisions, PC monitors and mobile devices.

*Imaging Solutions.* Net sales from Imaging Solutions increased \$16.1 million in the current period, or 55.1% compared to net sales generated in the prior-year period. This increase resulted from a 78.3% sales volume increase, particularly of small form factor VGA products, and was

partially offset by a 10.1% decrease in average selling prices.

*Semiconductor Manufacturing Services.* Net sales from Semiconductor Manufacturing Services for the six months ended June 29, 2008, were \$169.5 million, a \$36.7 million or 27.6% increase compared to net sales of \$132.8 million for the six months ended July 1, 2007. This increase was primarily due to a 36.0% sales volume increase.

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*Power Solutions.* Net sales from Power Solutions for the second quarter of 2008 were \$2.1 million. We shipped our first products and recorded our first sales revenue in the quarter.

*All other.* Net sales from All other for the six months ended June 29, 2008 were \$3.3 million compared to \$39.9 million for the six months ended July 1, 2007. This decrease of \$36.6 million represents primarily the revenue decrease from our unit processing services rendered to Hynix as Hynix increased its internal capacity. Sales revenue from unit processing services was \$0.3 million during the six months ended June 29, 2008, compared to \$36.6 million during the six months ended July 1, 2007.

**Net Sales by Geographic Region**

The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the six months ended June 29, 2008 and July 1, 2007, respectively:

	Six months ended June 29, 2008		Six months ended July 1, 2007	
	Amount	% of Total	Amount	% of Total
	<i>(in millions; %)</i>			
Korea	\$ 204.1	51.3%	\$ 216.7	62.7%
Asia Pacific	98.7	24.8	76.2	22.0
Japan	51.1	12.8	23.3	6.7
North America	34.8	8.7	22.2	6.4
Europe	9.1	2.3	7.4	2.1
Total net revenues	\$ 397.7	100.0%	\$ 345.8	100.0%

**Gross Profit**

	Six months ended June 29, 2008		Six months ended July 1, 2007		Change Amount
	Amount	% of net sales	Amount	% of net sales	
	<i>(in millions; %)</i>				
Display Solutions	\$ 38.5	21.7%	\$ 15.2	10.6%	\$ 23.3
Imaging Solutions	(1.0)	(2.1)	(0.1)	(0.5)	(0.8)
Semiconductor Manufacturing Services	57.1	33.7	14.6	11.0	42.5
Power Solutions	0.4	17.3			0.4
All other	2.0	61.7	13.0	32.7	(11.0)
	\$ 97.0	24.4%	\$ 42.7	12.3%	\$ 54.3

Total gross profit increased \$54.3 million in the six months ended June 29, 2008, or 127.3%, compared to the gross profit generated in the six months ended July 1, 2007. Gross profit percentage for the six months ended June 29, 2008 was 24.4% of net sales, an increase of 12.1% from 12.3% for the six months ended July 1, 2007. This increase in gross profit percentage was primarily attributable to an overall decrease in unit costs due to an increase in overall production volume and a decrease in depreciation expense.

*Display Solutions.* Gross profit percentage for Display Solutions for the six months ended June 29, 2008 improved to 21.7% compared to 10.6% for the six months ended July 1, 2007 primarily due to a 25.6% increase in sales volume and a decrease in unit costs that resulted from an increase in overall production volume.

*Imaging Solutions.* Gross profit percentage for the six months ended June 29, 2008 was minus 2.1% compared to minus 0.5% for the prior-year period mainly due to a 10.1% decrease in average selling prices.

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*Semiconductor Manufacturing Services.* Gross profit percentage for Semiconductor Manufacturing Services improved to 33.7% in the six months ended June 29, 2008 from 11.0% in the six months ended July 1, 2007. This increase was due to a 36.0% increase in sales volume and a decrease in unit costs, resulting from an increase in overall production volume.

*Power Solutions.* Gross profit percentage for Power Solutions was 17.3% for the six months ended June 29, 2008.

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*All other.* Gross profit percentage for All other for the current period increased to 61.7% from 32.7% for the prior-year period. This improvement in gross profit percentage is mainly attributable to lower fixed cost per unit.

***Operating Expenses***

*Selling, General and Administrative Expenses.* Selling, general, and administrative expenses were \$42.2 million or 10.6% of net sales for the six months ended June 29, 2008 compared to \$48.3 million or 14.0% for the six months ended July 1, 2007. The decrease of \$6.0 million or 12.5% from the prior-year period was mainly due to a \$3.5 million increase in gain from disposal of tangible assets and a \$2.0 million increase in miscellaneous income.

*Research and Development Expenses.* Research and development expenses for the current period were \$71.8 million, an increase of \$4.2 million or 6.2% from \$67.7 million for the prior year period. This increase in research and development expenses essentially represented our focus on the introduction of new products, especially for the Imaging Solutions and Display Solutions segments. As a percentage of net sales, research and development expenses for the six months ended June 29, 2008 decreased to 18.1% compared to 19.6% for the prior-year period.

*Restructuring and Impairment Charges.* During the six months ended June 29, 2008, we reversed \$0.9 million of unused restructuring accruals which were part of \$2.0 million of restructuring charges recognized during the second quarter ended July 1, 2007. The restructuring charges were related to the closure of our five-inch wafer fabrication facilities, and those charges consist of one-time termination benefits, transfer of machinery and other associated costs. Prior to and during the six months ended June 29, 2008, actual payments were charged against the restructuring accruals. The restructuring activities were substantially completed as of March 30, 2008.

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

***Other Income (Expense)***

*Interest Expense, Net.* Net interest expense was \$31.5 million during the six months ended June 29, 2008 compared to \$29.4 million for the six months ended July 1, 2007. Interest expense was incurred to service our notes in the amount of \$750.0 million and drawings under our senior secured facility. At June 29, 2008, the notes bore interest at a weighted average interest rate of 7.80%. Drawings under our senior secured credit facility bore interest at June 29, 2008 at either three-month LIBOR plus 4.75% or ABR plus 3.75%. The increase in net interest expense was mainly due to an increase in interest expense driven by drawdowns from our senior secured credit facility and a decrease in interest income from financial assets including cash and cash equivalents.

*Foreign Currency Gain (Loss), Net.* Net foreign currency loss for the six months ended June 29, 2008 was \$74.0 million, compared to net foreign exchange gain of \$6.5 million for the six months ended July 1, 2007.

A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss recorded for intercompany borrowings at our Korean subsidiary and is affected by changes in the exchange rate between the Korea won and the U.S. dollar. Foreign currency translation loss from the intercompany borrowings was included in determining our consolidated net income since the intercompany borrowings were not considered long-term investments in nature because management intended to repay these intercompany borrowings at their maturity dates. The Korean won to U.S. dollar exchange rates were 1,041.8:1 and 922.6:1 using the noon buying rate in effect as of June 29, 2008 and July 1, 2007, respectively, as quoted by the Federal Reserve Bank of New York.

***Income Tax Expenses***

*Income Tax Expenses.* Income tax expenses for the six months ended June 29, 2008 were \$5.8 million, compared to income tax expenses of \$4.1 million for the same period of 2007. Income tax expenses for the six months ended June 29, 2008 were comprised of \$2.0 million of current income taxes incurred in various jurisdictions in which we operate, \$2.9 million of withholding taxes mostly paid on intercompany interest payments and \$0.9 million of income tax increase effect from the change of deferred tax assets. Due to the uncertainty of the utilization of foreign tax credits, we did not recognize these withholding taxes as deferred assets.

***Liquidity and Capital Resources***

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Our principal capital requirements are to invest in research and development and capital equipment, to make debt service payments on the notes and our senior secured credit facility and to fund working capital needs. We anticipate that operating cash flow, together with available borrowing capacity under our senior secured credit facility, will be sufficient to



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meet our research and development and capital expenditures needs, to service requirements on our debt obligations and to fund our working capital needs for the foreseeable future. As of June 29, 2008, we had total outstanding long-term debt of \$750.0 million.

Our principal sources of liquidity are our cash, cash equivalents and available borrowings under our senior secured credit facility of \$100 million. As of June 29, 2008, our cash and cash equivalents balance was \$36.5 million or 5.7% of our total assets, a \$27.8 million decrease from \$64.3 million or 9.1% of total assets as of December 31, 2007. The decrease in cash and cash equivalents during the first half of 2008 was primarily attributable to cash outflow related to capital expenditures during the period of \$21.2 million, coupled with cash outflow of \$14.9 million in operating activities.

During the six months ended June 29, 2008, net cash used in operating activities was \$14.9 million, compared to \$50.0 million of net cash used in operating activities during the prior year period. This difference in cash from operating activities between the two periods was primarily attributable to increase in gross profit of \$54.3 million resulting mainly from higher revenue. The net operating cash outflow for the current period principally reflects our net loss of \$127.5 million adjusted by \$120.8 million which mainly consisted of depreciation and foreign currency translation loss and an increase in net operating assets of \$8.2 million.

Our working capital balance as of June 29, 2008 was \$20.8 million compared to \$55.6 million as of December 31, 2007. The decrease of \$34.8 million in our working capital balance was mainly due to a \$27.8 million reduction in cash and cash equivalents which was used to support our capital investment and operations and a \$26.2 million increase in current liabilities due to the timing of payments at the end of the second quarter. This decrease was partially offset by an increase in accounts receivable of \$25.4 million due to increase in revenue and a timing of receipts at the end of the second quarter.

For investing activities, net cash outlay during the six months ended June 29, 2008 was \$17.9 million, compared to \$24.1 million in the prior-year period, primarily related to capital expenditures and partial offset by a cash inflow from the sales of tangible assets.

For the six months ended June 29, 2008, there were no significant financing activities other than drawdowns and repayments from our senior secured credit facility, consistent with the prior-year period.

Borrowings under the senior secured credit facility are subject to the satisfaction of certain conditions, including the representations and warranties being true in all material respects, compliance with the covenants included in the senior secured credit facility (including the financial covenants) and no default occurring or continuing on the date of the borrowing. The senior secured credit facility agreement contains certain customary covenants and restrictions for a facility of this type, including those with respect to the future maintenance and conduct of the business, the incurrence of debt or liens, the making of certain investments, and the consummation of sale/leaseback transactions, affiliate transactions, mergers and consolidations, asset sales, distributions and dividends on capital stock, and certain acquisitions. The senior secured credit facility also contains financial covenants including:

maintaining a minimum coverage of interest expense;

maintaining debt leverage below specified levels;

maintaining a minimum level of consolidated EBITDA;

maintaining a minimum level of liquidity; and

limiting capital expenditures under specified thresholds.

On April 19, 2007, Moody's Investor Service, Inc. downgraded the ratings on our indebtedness. We may experience additional downgrades in our debt ratings, which may make it more difficult for us to obtain favorable interest rates and other terms on any new debt we may choose to incur in the future, including any new debt we may incur to refinance existing indebtedness. In the event any ratings downgrades are significant, we may choose not to incur new debt or refinance existing debt if we are unable to incur or refinance such debt at favorable interest rates or on favorable terms.

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*Capital Expenditures.* For the six months ended June 29, 2008, capital expenditures were \$21.2 million, a \$3.8 million or 15.1% decrease from \$25.0 million for the six months ended July 1, 2007.

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

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We may need to incur additional debt or issue equity to make strategic acquisitions of investments. There can be no assurance that any such financing will be available to us on acceptable terms, or that such financing will be available at all. Our senior secured credit facility and the indentures governing our notes restrict our ability to incur additional debt.

### Seasonality

Our net sales and number of distinct products sold are affected by market variations from quarter to quarter due to the business cycles, and resulting product demand, of our customers. Our Imaging and Display Solutions businesses typically experience demand increases in the third and fourth calendar quarters due to increased holiday demand for the consumer products that serve as the end markets for our products. During the first quarter, by contrast, consumer products manufacturers generally reduce orders in order to burn off excess inventory from the holiday season. In our Semiconductor Manufacturing Services business, the supply-demand cycle is usually one quarter ahead of the broader semiconductor market due to lead time from wafer input to shipment to our customers, so the demand for these products tends to peak in the third quarter and begin slowing in the fourth and first quarters.

### Contractual Obligations

Summarized in the table below are estimates of future payments under debt obligations and minimum lease payment obligations at June 29, 2008. Changes in our business needs or interest rates, as well as actions by third parties and other factors, may cause these estimates to change. Because these estimates are complex and necessarily subjective, our actual payments in future periods are likely to vary from those presented in the table below.

	Total	Payments Due by Period					Thereafter
		2008	2009	2010	2011	2012	
Senior secured credit facility <sup>(1)(2)</sup>	\$ 85.2	\$ 85.2	\$	\$	\$	\$	\$
Notes <sup>(1)(3)</sup>	990.2	26.0	51.9	51.9	551.0	20.0	289.4
Operating lease	47.7	5.3	10.6	10.6	10.6	10.6	
Others <sup>(1)</sup>	19.7	4.1	8.2	6.5	0.7	0.2	

(1) Includes interest obligations thereon.

(2) Represents amounts outstanding under the senior secured credit facility.

(3) Includes interest obligations on the notes. For purposes of estimating the interest obligations under our Floating Rate Second Priority Senior Secured Notes, we used the average interest rate for such notes during the six months ended June 29, 2008.

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 on these notes are 3 month LIBOR + 3.25%, 6 7/8% and 8%, respectively. We expect to pay the amounts outstanding under these notes in full upon maturity.

Each indenture governing the notes contains covenants that limit our ability and that of our subsidiaries to (1) incur additional indebtedness, (2) pay dividends or make other distributions on our capital stock or repurchase, repay or redeem our capital stock, (3) make certain investments, (4) incur liens, (5) enter into certain types of transactions with affiliates, (6) create restrictions on the payment of dividends or other amounts to us by our subsidiaries, and (7) sell all or substantially all of our assets or merge with or into other companies.

In November 2007, the lenders under our senior secured credit facility waived certain provisions of the credit agreement to permit us to consummate our proposed corporate reorganization and proposed public offering and to use the proceeds from the public offering as described in our registration statement. Upon consummation of the proposed corporate reorganization, MagnaChip Semiconductor Corporation will become a guarantor and grant a security interest with respect to the obligations under the senior secured credit facility.

We adopted the provisions of FIN No. 48, *Accounting for Uncertainty in Income Taxes* on January 1, 2007. Our unrecognized tax benefits totaled \$1.6 million as of June 29, 2008. 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

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On December 23, 2004, two of our subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, entered into a senior secured 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 our senior secured credit facility as of June 29, 2008 and December 31, 2007 was \$3.5 million and \$4.5 million, respectively. The utilized portions of the credit facility are related to the issuance of letters of credit and cash drawdowns.

Other than the senior secured credit facility, we believe 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.

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**Table of Contents****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. We are currently evaluating the potential impact, if any, of the adoption of SFAS 141R on our 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. We are currently evaluating the potential impact, if any, of the adoption of SFAS 160 on our 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.

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.

**Critical Accounting Policies and Estimates**

The preparation of our consolidated financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosures regarding contingent assets and liabilities. We base these estimates and judgments on historical experience, knowledge of current conditions and other assumptions and information that we believe to be reasonable. Estimates and assumptions about future events and their effects cannot be perceived with certainty. Accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the business environment in which we operate changes.

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We have defined a critical accounting estimate as one that is both important to the portrayal of either our financial condition or results of operations and requires us to make difficult, subjective or complex judgments or estimates about matters that are uncertain. We have discussed the development and selection of our critical accounting policies with the audit committee of our board, and the audit committee has reviewed the disclosure presented below. We believe that the following are the critical accounting estimates used in the preparation of our consolidated financial statements. In addition, there are other items within our consolidated financial statements that require estimation but which we do not deem to be critical.

***Revenue Recognition and Account Receivables Valuation***

Our revenue is primarily derived from the sale of semiconductor products which 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.

We recognize revenue upon shipment, upon delivery of the product at the customer's location or upon customer acceptance depending on terms of the arrangements, when the risks and rewards of ownership have passed to the customer. 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 currently manufacture a substantial portion of our products internally at our wafer fabrication facilities. In the future, we expect to rely, to some extent, on outside wafer foundries for additional capacity and advanced technologies.

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. The establishment of reserves for sales discounts is based on management judgments that require significant estimates of a variety of factors, including forecasted demand, returns and industry pricing assumptions. We record warranty liabilities for the estimated costs that may be incurred under our limited warranty. This warranty covers product defects based on compliance with our specifications and is normally applicable for twelve months from the date of purchase. These liabilities are accrued when revenues are recognized. Warranty costs include the costs to replace the defective products. Factors that affect our warranty liability include historical and anticipated rates 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 valued at the lower of cost or market, using the average method which approximates the first in, first out method. Because of the cyclical nature of the semiconductor industry, changes in inventory levels, obsolescence of technology and product life cycles, we write down inventories to net realizable value. The difference in the carrying amount and the net realizable value is recognized as a loss on valuation of inventories within cost of sales. We estimate the net realizable value for such finished goods and work-in-progress based primarily upon the latest invoice prices and current market conditions.

We employ a variety of methodologies to determine the amount of inventory reserves necessary. While a portion of the reserve is determined via reference to the age of inventory and lower of cost or market calculations, an element of the reserve is subject to significant judgments made by us about future demand for our inventory. For example, reserves are established for excess inventory based on inventory levels in excess of six months of projected demand, as judged by management, for each specific product. If actual demand for our products is less than our estimates, additional reserves for existing inventories may need to be recorded in future periods.

In addition, as prescribed in SFAS No. 151, *Inventory Costs*, the cost of inventories is determined based on the normal capacity of each fabrication facility. If the capacity utilization is lower than a level that management believes to be normal, the fixed overhead costs per production unit which exceed those which would be incurred when the fabrication facilities are running under normal capacity are charged to cost of sales rather than capitalized as inventories.

***Long-Lived Assets***

We assess long-lived assets for impairment when events or changes in circumstances indicate that the carrying value of the assets or the asset group may not be recoverable. Factors that we consider in deciding when to perform an impairment



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review include significant under-performance of a business or product line in relation to expectations, significant negative industry or economic trends, and significant changes or planned changes in our use of the assets. Recoverability of assets that will continue to be used in our operations is measured by comparing the carrying amount of the asset group to our estimate of the related total future undiscounted net cash flows. If an asset group's carrying value is not recoverable through the related undiscounted cash flows, the asset group is considered to be impaired. The impairment is measured by the difference between the asset group's carrying amount and its fair value determined by either a quoted market price, if any, or a value determined by utilizing a discounted cash flow technique.

Impairments of long-lived assets are determined for groups of assets related to the lowest level of identifiable independent cash flows. We must make subjective judgments in determining the independent cash flows that can be related to specific asset groupings. Additionally, an evaluation of impairment of long-lived assets requires estimates of future operating results that are used in the preparation of the expected future undiscounted cash flows. Actual future operating results and the remaining economic lives of our long-lived assets could differ from the estimates used in assessing the recoverability of these assets.

***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 regularly review our deferred tax assets for recoverability considering historical profitability, projected future taxable income, the expected timing of the reversals of existing temporary differences and expiration of tax credits and net operating loss carryforwards. 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 established since it is more likely than not that the deferred tax assets at this subsidiary will be realizable based on the current prospects for its future taxable income.

Changes in our evaluation of our deferred income tax assets from period to period could have a significant effect on our net operating results and financial condition.

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 a greater than 50 percent likely of ultimately being realized.

***Accounting for Unit-based Compensation***

In 2006, we adopted SFAS No. 123(R) using the modified prospective application method and began to account for unit-based compensation based on a fair value method. Under 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. Consistent with our prior-period pro forma presentation under SFAS No. 123, we use the Black-Scholes option pricing model to value unit 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 determination of the fair value of our common units on each grant date was a two-step process. First, management estimated our enterprise value in consultation with such advisers as we deemed appropriate. Second, this business enterprise value was allocated to all sources of capital invested in us based on each type of security's respective rights and claims to our total business enterprise value. This allocation included a calculation of the fair value of our common units on a non-marketable, minority basis. The business enterprise value was determined based on an income approach and a market approach using the revenue multiples of comparable companies, giving appropriate weight to each approach. The income approach was based on the discounted cash flow method and an estimated weighted average cost of capital. The estimated fair value of our common units was calculated using an option pricing model, using the enterprise value, an estimated volatility, expected exercise term and a risk free interest rate.





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Determination of the fair value of our common units involves complex and subjective judgments regarding projected financial and operating results, our unique business risks, the liquidity of our units and our operating history and prospects at the time of grant. If we make different judgments or adopt different assumptions, material differences could result in the amount of the share-based compensation expenses recorded because the estimated fair value of the underlying units for the options granted would be different.

**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 June 29, 2008 for our Korean subsidiary, a 10% devaluation of the Korean won against the U.S. dollar would have resulted in a decrease of \$1.4 million in our U.S. dollar financial instruments balance and cash balance. Based on the Japanese yen cash balance at June 29, 2008, a 10% devaluation of the Japanese yen against the U.S. dollar would have resulted in a decrease of \$40.6 thousand in our U.S. dollar cash balance.

*Interest Rate Risk.* The \$200 million 6 <sup>7</sup>/<sub>8</sub>% second priority senior secured notes due 2011 and the \$250 million 8% senior subordinated notes due 2014 are subject to changes in fair value due to interest rate changes. If the market interest rate had decreased by 10% and all other variables were held constant from their levels at June 29, 2008, we estimate that we would have additional interest expense costs over the market rate of \$3.0 million (on a 360-day basis). The fair value of these fixed rate notes would have decreased by \$6.2 million or increased by \$6.4 million with a 10% increase or decrease in the interest rate, respectively.

*Cash Flow Interest Rate Risk.* We have cash flow interest rate risk related to our \$300 million Floating Rate Second Priority Senior Secured Notes due 2011 as interest expense is subject to prevailing market interest rates at each balance sheet date. If the market interest rate had increased by 10% and all other variables were held constant from their levels at June 29, 2008, we estimate that we would have additional interest expense of \$1.0 million (181 days basis) for these floating rate notes and our net loss for the six months ended June 29, 2008 would have increased by 0.79%.

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

As required by the Securities Exchange Act of 1934, as amended, or the Exchange Act, our management, including our Chief Executive Officer, or our CEO, and our Chief Financial Officer, or our 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

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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.

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

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

## **PART II OTHER INFORMATION**

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

*You should carefully consider the risk factors set forth below as well as the other information contained in this report. Any of the following risks could materially and adversely affect our business, financial condition or results of operations. Additional risks and uncertainties not currently known to us or those currently viewed by us to be immaterial may also materially and adversely affect our business, financial condition or results of operations.*

#### **The cyclical nature of the semiconductor industry may limit our ability to maintain or increase net sales and operating results 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. A downturn can result in lower unit volumes and rapid erosion of average selling prices. The semiconductor industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers' products or a decline in general economic conditions. We have experienced these conditions in our business in the past and may experience renewed, and possibly more severe and prolonged, downturns in the future as a result of such cyclical changes. This may reduce our results of operations and the value of our business.

We base our planned operating expenses in part on our expectations of future revenue, and a significant portion of our expenses is relatively fixed in the short term. If revenue for a particular quarter is lower than we expect, we likely will be unable to proportionately reduce our operating expenses for that quarter, which would harm our operating results for that quarter.

#### **We manufacture our products based on our estimates of customer demand, and if our estimates are incorrect our financial results could be negatively impacted.**

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 demand and expected demand for and success of their products. 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 estimate accurately future customer demand for our products. On occasion, customers may require rapid increases in supply, which can challenge our production resources and reduce margins. We may not have sufficient capacity at any given time to meet our customers' increased demand for our products. Conversely, downturns in the semiconductor industry have caused and may in the future cause our customers to reduce significantly the amount of products they order from us. Because many of our costs and operating expenses are relatively fixed, a reduction in customer demand would decrease our results of operations, including our gross profit.

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

We generally do not obtain firm, long-term purchase commitments from our customers. Customers may cancel their orders, reduce 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 periodic downturns in the semiconductor industry or failure to achieve design wins, have affected and may continue to affect our results of operations adversely. These risks are exacerbated because many of our products are customized, which hampers our ability to sell excess inventory to the general market. 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 pricing, our margins and results of operations would be adversely affected.

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

An important factor in our success is the extent to which we are able to utilize the available capacity in our fabrication facilities. As many of our costs are fixed, a reduction in capacity utilization, as well as changes in other factors such as reduced yield or unfavorable 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.

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

Historically, we have relied on a limited number of customers for a substantial portion of our total revenue. If we were to lose key customers or if customers cease to place orders for our high volume products or services, our financial results would be adversely affected. While we served more than 179 customers in the six months ended June 29, 2008, net sales to our 10 largest customers represented approximately 59.6% of our net sales for the period. One customer represented greater than 10% of our net sales during the six months ended June 29, 2008. Significant reductions in sales to any of these customers, the loss of major customers or a general curtailment in orders for our high volume products or services 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 both within our product categories and end markets. Current and prospective customers for our products and services evaluate our capabilities against the merits of our 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 certain of our end markets and with the internal semiconductor design and manufacturing 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 will depend on a number of factors, including the following:

our ability to offer cost-effective and high quality products and services 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;

our ability to continue to rapidly introduce new products that are accepted by the market;

our ability to adopt or adapt to emerging industry standards;

the number and nature of our competitors and competitiveness of their products and services in a given market; and

entrance of new competitors into our markets.

Many of these factors are outside of our control. In the future, our competitors may replace us as a supplier to our existing or potential customers, and our customers may satisfy more of their requirements internally. As a result, we may experience declining revenues and results of operations.

**The average selling prices of our semiconductor products have at times declined rapidly and will likely do so in the future, which could harm our revenue and gross profit.**

The semiconductor products we develop and sell are subject to rapid declines in average selling prices. From time to time, we have had to reduce our prices significantly to meet customer requirements, and we may be required to reduce our prices in the future. This would cause our gross profit to decrease. Our financial results will suffer if we are unable to offset any reductions in our average selling prices by increasing our sales volumes, reducing our costs or developing new or enhanced products on a timely basis with higher selling prices or gross profit.

**Changes in demand for consumer electronics, including digital televisions, notebook computers, flat panel displays and mobile phones, and products in our other end markets can impact our results of operations.**

Demand for our products will depend in part on the changes in demand for various consumer electronics products, including digital televisions, notebook computers, flat panel displays and mobile phones, and electronics products in our other end markets and on general economic growth. To the extent that we cannot offset periods of reduced demand that may occur in these markets through greater penetration of these markets or reduction in our production and costs, our sales and gross profit may decline, which would negatively impact our business, financial condition and results of operations.

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### **If we fail to develop new products and process technologies or enhance our existing products and services in order to react to rapid technological change and market demands, our business will suffer.**

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 advanced process technologies or to license or otherwise obtain essential intellectual property required by our customers.

We must develop new products and services and enhance our existing products and services to meet rapidly evolving customer requirements. We design products for customers who continually require higher performance and functionality at lower costs. We must, therefore, continue to enhance the performance and functionality of our products. The development process for these advancements is lengthy and requires us to accurately anticipate technological changes and market trends. Developing and enhancing these products is uncertain and can be time-consuming, costly and complex. If we do not continue to develop and maintain process technologies that are in demand by our semiconductor manufacturing services customers, we may be unable to maintain existing customers or attract new customers.

Customer and market requirements can change during the development process. There is a risk that these developments and enhancements will be late, fail to meet customer or market specifications or not be competitive with products or services from our competitors that offer comparable or superior performance and functionality. For example, net sales generated in 2006 by our Imaging Solutions business decreased \$102.8 million, or 63%, compared to net sales generated by that business in 2005. This decrease was primarily attributable to delays in transitioning to new megapixel products. We began marketing a new line of power management solutions in 2008. Any new products, such as our new power management solutions, or product or service enhancements may not be accepted in new or existing markets. Our business will suffer if we fail to develop and introduce new products and services or product and service enhancements on a timely and cost-effective basis.

### **If we fail to achieve design wins for our semiconductor products, we may lose the opportunity for sales to customers for a significant period of time and be unable to recoup our investments in our products.**

We expend considerable resources to achieve design wins for our semiconductor products, especially our new products and product enhancements. Once a customer designs a semiconductor into a product, that customer is likely to continue to use the same semiconductor or enhanced versions of that semiconductor from the same supplier across a number of similar and successor products for a lengthy period of time due to the significant costs associated with qualifying a new supplier and potentially redesigning the product to incorporate a different semiconductor. If we fail to achieve an initial design win in a customer's qualification process, we may lose the opportunity for significant sales to that customer for a number of products and for a lengthy period of time. This may cause us to be unable to recoup our investments in our semiconductor products, which would harm our business.

### **We have lengthy and expensive design-to-mass production and manufacturing process development cycles.**

The cycle time from the design stage to mass production for some of our products is long and requires the investment of significant resources with many potential customers without any guarantee of sales. Our design-to-mass production cycle typically begins with a three-to-twelve month semiconductor development stage and test period followed by a three-to-twelve month end-product qualification period by our customers. The fairly lengthy front end of our sales cycle creates a risk that we may incur significant expenses but may be unable to realize meaningful sales. Moreover, prior to mass production, customers may decide to cancel their products or change production specifications, resulting in sudden changes in our product specifications, increasing our production time and costs. Failure to meet such specifications may also delay the launch of our products or result in lost sales.

In addition, we collaborate and jointly develop certain process technologies and manufacturing process flows custom to certain of our semiconductor manufacturing services customers. To the extent that our semiconductor manufacturing services customers fail to achieve market acceptance for their products, we may be unable to recoup our engineering resources commitment and our investment in process technology development, which would harm our business.

### **We face numerous challenges relating to executing our growth strategy.**

As part of our growth strategy, we began marketing a new line of power management semiconductor products and expect to introduce other new products and services in the future. If we are unable to execute our growth strategy effectively, we may not be able to take advantage of market opportunities, execute our business plan or respond to competitive pressures. Moreover, if our allocation of resources does not correspond with future demand for particular products, we could miss market opportunities, and our business and financial results could be materially and adversely affected.





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### **The loss of our key employees would materially adversely affect our business, and we may not be able to attract or retain the technical or management employees necessary to compete in our industry.**

Our key executives have substantial experience and have made significant contributions to our business, and our continued success is dependent upon the retention of our key management executives, including our Chief Executive Officer and Chairman, Sang Park, and our President and Chief Financial Officer, Robert Krakauer, as well as the services provided by our engineers and a number of other key managerial, marketing, planning, financial, technical and operations personnel. The loss of such key personnel would have a material adverse effect on our business. Growth in our business is dependent, to a large degree, on our ability to retain and attract such employees. In addition, 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. This could hinder our research and product development programs or otherwise have a material adverse effect on our business.

### **We have a history of losses and may not become profitable in the future.**

Since we began operations as a separate entity in 2004, we have not generated a profit and have generated significant net losses. As of June 29, 2008, we had an accumulated deficit of approximately \$698.3 million and negative unitholders' equity. To become profitable, we will need to generate and sustain substantially higher revenue while maintaining or reducing expenses. We currently expect to incur higher expenses in each of the next several quarters to support increased research and development and sales and marketing efforts. These expenditures may not result in increased revenue or an increase in the number of customers immediately or at all. Because many of our expenses are fixed in the short term, or are incurred in advance of anticipated sales, we may not be able to decrease our expenses in a timely manner to offset any shortfall of sales. If we become profitable, we may not be able to sustain or increase profitability on a quarterly or an annual basis.

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

As of June 29, 2008, approximately 59.7% 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 can offer no assurance that issues with the labor union and other employees will be resolved favorably for us in the future, that we will not experience work stoppages or other labor problems in future years or that we will not incur significant expenses related to such issues.

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

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. Any such transaction 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 determined to be worth less than the amount paid for them in an earlier acquisition. In addition, our senior secured credit facility and the indentures governing our senior secured notes and senior subordinated notes may restrict us from making acquisitions that we may otherwise wish to pursue.

### **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 specialized equipment. We may have difficulty achieving acceptable yields in the manufacture of our products or those of our semiconductor manufacturing services customers, which could lead to higher costs, a loss of customers or delay in market acceptance of our products. Slight impurities or defects in the photomasks 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. Yields below our target levels can negatively impact our gross profit and may cause us to eliminate underperforming products.

### **We rely on a number of independent subcontractors.**

A substantial portion of our net sales are derived from semiconductor devices assembled in packages or on film. The packaging and testing of semiconductors require technical skill and specialized equipment. For the portion of packaging and testing that we outsource, we use subcontractors located in Korea and Southeast Asia. We rely on these subcontractors to



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package and test our devices with acceptable quality and yield levels. If our semiconductor packagers and test service providers experience problems in packaging and testing our semiconductor devices, experience prolonged quality or yield problems or decrease the capacity available to us, our operating results could be adversely affected.

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

We use a wide range of parts and materials in the production of our semiconductors, including silicon, processing chemicals, processing gasses, precious metals and electronic and mechanical components. We procure materials and electronic and mechanical components from international sources and original equipment manufacturers. From time to time in the past, the supply of polysilicon available for use in the manufacture of semiconductor products has been constrained, and we may confront similar constraints in the future. If we cannot obtain adequate materials in a timely manner or on favorable terms for the manufacture of our products, revenues and results of operations will decline.

### **We face product return and 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 return and 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. Our sales may decline if any of our customers are sued on a product liability claim. We also may 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. Further, if our products are delivered with impurities or defects, we could incur additional development, repair or replacement costs, and our credibility and the market's acceptance of our products could be harmed.

### **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 on assumptions about the various tax laws, including withholding tax, and other laws of applicable non-U.S. jurisdictions. In addition, our Korean subsidiary, MagnaChip Semiconductor, Ltd., or MagnaChip Korea, was granted a limited tax holiday under Korean law in October 2004. This grant provides for certain tax exemptions for corporate taxes and withholding taxes until December 31, 2008, and for acquisition taxes, property and land use taxes and other taxes until December 31, 2013. In addition, we do not expect the income of our foreign subsidiaries to be subject to taxation in the United States by reason of the Subpart F regime. Our interpretations and conclusions regarding tax and other laws are not binding on any taxing authority and, if these assumptions and conclusions are incorrect, if our business were to be operated in a way that rendered us ineligible for tax exemptions or to become subject to incremental tax, 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 organizational structure materially impaired.

### **Our ability to compete successfully and achieve future growth will depend, in part, on our ability to protect our proprietary technology and know-how, 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. There can be no assurance 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 to protect these technologies may be breached and may not be adequate to protect our proprietary technologies. There can be no assurance that other countries in which we market our services will protect our intellectual property rights to the same extent as the United States.

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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. We may need to file lawsuits to enforce our patents or intellectual property rights, and we may need to defend against claimed infringement of the rights of others. Any litigation could result in substantial costs to us and divert our resources. Despite our efforts in bringing or defending lawsuits, we may not be able to prevent third parties from infringing upon or misappropriating our intellectual property. 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.

There can be no assurance 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. In addition, many of our patents are subject to cross licenses, several of which are with our competitors. The noncompetition arrangement agreed to by Hynix in connection with our acquisition from Hynix, or the Original Acquisition, expired on October 1, 2007. Under that arrangement, Hynix retained a perpetual license to use the intellectual property that we acquired from Hynix in the Original Acquisition. Now that these noncompetition restrictions have expired, Hynix and its subsidiaries are free to develop products that may incorporate or embody intellectual property developed by us prior to October 2004.

### **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 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, change frequently and have tended to become more stringent over time. There can be no assurance that we have been, or will be, in compliance with all such laws and regulations or that we will not incur material costs or liabilities in connection with these laws and regulations in the future. The adoption of new environmental, health and safety laws, the failure to comply with new or existing laws, or issues relating to hazardous substances could subject us to material liability (including substantial fines or penalties), impose the need for additional capital equipment or other process requirements upon us, curtail our operations or restrict our ability to expand operations.

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

We may require more capital in the future from equity or debt financings to fund our operations, finance investments in equipment and infrastructure, acquire complimentary businesses and technologies, and respond to competitive pressures and potential strategic opportunities. If we raise additional funds through further issuances of equity or other securities convertible into equity, our existing equityholders could suffer significant dilution, and any new securities we issue could have rights, preferences or privileges senior to those of the holders of our equity securities. In addition, additional capital may not be available when needed or, if available, may not be available on favorable terms. In addition, our senior secured credit facility and the indentures governing our notes limit our ability to incur additional indebtedness under certain circumstances. 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 this may have a material adverse effect on our business, financial condition and results of operations.

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

We invest significant resources in our research and development. Our research and development efforts, however, may not yield commercially viable products or enhance our semiconductor manufacturing services offerings. During each stage of research and development there is a substantial risk that we will have to abandon a potential product or service offering which is no longer marketable and in which we have invested significant resources. In the event we are able to develop viable new products or service offerings, 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.

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### **Our business depends on international customers, suppliers and operations in Asia, and as a result we are subject to regulatory, operational, financial and political risks, which could adversely affect our financial results.**

We rely on, and expect to continue to rely on, suppliers, subcontractors and operations located primarily in Asia. As a result, 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 receivable 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. Although we do not derive any revenue from, nor sell any products in, North Korea, any future increase in tensions between South Korea and North Korea which may occur, for example, an outbreak of military hostilities, would adversely affect our business, financial condition and results of operations.

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

Our net sales are primarily denominated in U.S. dollars, as well as various other currencies, including the Korean won, Japanese yen and euro. 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. Conversely, during 2007, more than 60% of our costs were denominated in Korean won and, to a lesser extent, in Japanese yen, U.S. dollars and euros. Therefore, changes in the exchange rates of these currencies or any other applicable currencies to the U.S. dollar will affect our cost of goods sold and operating margins and could result in exchange losses. As a result, a material decline in the U.S. dollar relative to the Korean won will result in an increase in our costs as a proportion of our net sales, thereby reducing our operating margins.

We cannot fully predict the impact of future exchange rate fluctuations on our profitability. We have not engaged in exchange rate hedging since the Original Acquisition. From time to time, we may engage in exchange rate hedging activities in an effort to mitigate the impact of exchange rate fluctuations. However, there can be no assurance that any hedging technique we implement will be effective. If such hedging is not effective, we may experience reduced operating margins.

### **Our level of indebtedness is substantial, and we may not be able to generate sufficient cash to service all of our indebtedness and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful. A decline in the ratings of our existing or future indebtedness may make the terms of any new indebtedness we choose to incur more costly.**

As of June 29, 2008, our total indebtedness representing long and short-term borrowings, including the current portion of long-term borrowings, was approximately \$835 million. Our substantial debt could have important consequences, including:

increasing our vulnerability to general economic and industry conditions;

requiring a substantial portion of our cash flow from operations to be dedicated to the payment of principal and interest on our indebtedness, therefore reducing our ability to use our cash flow to fund our operations, capital expenditures and future business opportunities;

exposing us to the risk of increased interest rates because some of our borrowings are at variable rates of interest;

limiting our ability to obtain additional financing for working capital, capital expenditures, debt service requirements, acquisitions and general corporate or other purposes; and

limiting our ability to adjust to changing market conditions and placing us at a competitive disadvantage compared to our competitors who have less debt.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. There can be no assurance that we will generate a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if

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any, and interest on our indebtedness. For example, in 2006 our cash interest expense exceeded the cash generated from our operating activities, and in 2007 our cash flow from operating activities was negative and did not cover any of our interest expense.

On April 19, 2007, Moody's Investor Service, Inc. downgraded the ratings on our indebtedness. The credit ratings assigned to our debt reflect the rating agency's opinion of our ability to make payments on the debt obligations when such payments are due. A rating may be subject to revision or withdrawal at any time by the assigning rating agency. We may experience downgrades in our debt ratings in the future, which may make it more difficult for us to obtain favorable interest rates and other terms on any new debt we may choose to incur in the future, including any new debt we may incur to refinance existing indebtedness. In the event any ratings downgrades are significant, we may choose not to incur new debt or refinance existing debt if we are unable to incur or refinance such debt at favorable interest rates or on favorable terms.

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If our cash flows and capital resources are insufficient to fund our debt service obligations or if we are unable to refinance existing indebtedness on favorable terms, we may be forced to reduce or delay capital expenditures, sell assets, seek additional capital or restructure or refinance our indebtedness. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. The credit agreement governing our senior secured credit facility and the indentures governing our notes restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or be able to obtain the proceeds which we could realize from them and these proceeds may not be adequate to meet any debt service obligations then due.

### **Our expenses could increase if Hynix were unwilling or unable to provide certain services related to our shared facilities with Hynix, and if Hynix were to become insolvent, we could lose certain of our leases.**

Because we share certain facilities with Hynix, several 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.

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

We are 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, 2009, our independent auditors will be required to attest to and report on 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 and could result in investigations or sanctions by the SEC, the applicable securities exchange on which our securities are listed or other regulatory authorities or in securityholder litigation. Any of these factors ultimately could harm our business and could negatively impact the market price of our securities. Ineffective control over financial reporting could also cause investors to lose confidence in our reported financial information, which could adversely affect the trading price of our securities.

Our disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives. However, our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, 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. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected.

### **We may need to incur impairment and other restructuring charges, which could materially affect our results of operations and financial conditions.**

During industry downturns and for other reasons, we may need to record impairment or restructuring charges. From the Original Acquisition in October 2004 through June 29, 2008, we recognized aggregate restructuring and impairment charges of \$141.7 million, which consisted of \$136.5 million of impairment charges and \$5.2 million of restructuring charges. In the future, we may need to record additional impairment charges or to further restructure our business and incur additional restructuring charges, any of which could have a material adverse effect on our results of operations or financial condition.



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

On April 14, 2008, one of our former executives exercised options to acquire 143,272.50 of our common units at a purchase price of \$143,272.50. Because the offering transaction took place outside the U.S. and the optionee was not a U.S. person, the issuance of these securities was exempt from registration under Regulation S of the Securities Act of 1933, as amended.

**Item 6. Exhibits.**

<b>Exhibit Number</b>	<b>Description</b>
31.1	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Executive Officer.
31.2	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Financial Officer.
32.1	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer.
32.2	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer.

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**SIGNATURES**

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

MAGNACHIP SEMICONDUCTOR LLC

Dated: August 12, 2008

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

Dated: August 12, 2008

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

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