

MAGNACHIP SEMICONDUCTOR LLC

Form 10-K

March 31, 2008

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

Washington, D.C. 20549

**FORM 10-K**

(Mark one)

**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**  
For the fiscal year ended December 31, 2007

or

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

Commission file number 333-126019-09

**MAGNACHIP SEMICONDUCTOR LLC**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or other jurisdiction of  
incorporation or organization)  
c/o MagnaChip Semiconductor S.A.

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

**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**

**Securities registered pursuant to Section 12(b) of the Act: None.**

**Securities registered pursuant to Section 12(g) of the Act: None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes  No

**Note** Checking the box above will not relieve any registrant required to file reports pursuant to Section 13 or 15(d) of the Exchange Act from their obligations under those Sections.

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 "accelerated filer," "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a  
smaller reporting company)

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

State the aggregate market value of the voting and non-voting common equity held by non-affiliates computed by reference to the price at which the common equity was last sold, or the average bid and asked price of such common equity, as of the last business day of the registrant's most recently completed second fiscal quarter. **Not applicable.**

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As of December 31, 2007, the registrant had 52,844,222 of the registrant's common units outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None.

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**Supplemental Information to be Furnished With Reports Filed Pursuant to Section 15(d) of the Act by Registrants Which Have Not Registered Securities Pursuant to Section 12 of the Act.**

No annual report or proxy statement, form of proxy or other proxy soliciting material with respect to any annual or other meeting of security holders has been sent to security holders.

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**MAGNACHIP SEMICONDUCTOR LLC**

**2007 FORM 10-K ANNUAL REPORT**

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**PART I**

**INDUSTRY AND MARKET DATA**

In this report, we rely on and refer to information regarding the semiconductor market from iSuppli Corporation, or iSuppli, and Gartner, Inc., or Gartner. Market data attributed to iSuppli is from Application Market Forecast Tool Worldwide Q2 2007 and market data attributed to Gartner is from Gartner Semiconductor Forecast Worldwide: Forecast Database November 28, 2007. Although we believe that this information is reliable, we have not independently verified it. We do not have any obligation to announce or otherwise make publicly available updates or revisions to forecasts contained in these documents. In addition, in many cases, we have made statements in this report regarding our industry and our position in the industry based on our experience in the industry and our own investigation of market conditions.

The Gartner report described herein represents data, research opinion or viewpoints published, as part of a syndicated subscription service available only to clients, by Gartner, Inc., a corporation organized under the laws of the State of Delaware, USA, and its subsidiaries, and is not a representation of fact. The Gartner report does not constitute a specific guide to action. Each Gartner report speaks as of its original publication date (and not as of the date of this report) and the opinions expressed in the Gartner report are subject to change without notice. Although we believe that this report is reliable, we have not independently verified the information contained in it.

In this report, the terms we, us, our and MagnaChip refer to MagnaChip Semiconductor LLC and its consolidated subsidiaries and the term Korea refers to the Republic of Korea or South Korea.

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Information concerning us is subject to 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. These statements can be identified 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 timing or 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, the Risk Factors, Management's Discussion and Analysis of Financial Condition and Results of Operations and Business sections and elsewhere in this report and listed below:

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

customer demand is difficult to accurately forecast;

our customers may cancel their orders, reduce quantities or delay production;

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a significant portion of our sales comes from a relatively limited number of customers;

our industry is highly competitive;

a decline in average selling prices of our products could decrease our profits;

growth in the consumer electronics and other end markets for our products is an important component in our success;

we depend on successful technological advances for growth;

we may not be able to attract or retain the technical or management employees necessary to remain competitive in our industry;

if we encounter future labor problems, we may fail to deliver our products in a timely manner which could adversely affect our revenues and profitability;

we have a history of losses and may not become profitable in the future;

the improvements and innovations we expect from our research and development efforts may not materialize; and

the costs of our raw materials may increase materially.

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.

MagnaChip and IC Media are registered trademarks of us and our subsidiaries. An application for United States trademark registration of MagnaChip Everywhere is pending in the name of MagnaChip Semiconductor, Ltd. All other product, service and company names mentioned in this report are the service marks or trademarks of their respective owners.

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**Item 1. Business.**

**BUSINESS**

**Recent Events**

On November 14, 2007, we filed a registration statement on Form S-1 (file no. 333-147388) with the Securities and Exchange Commission in connection with the initial public offering of shares of common stock of MagnaChip Semiconductor Corporation, which we refer to in this report as the proposed public offering. If the proposed public offering occurs, a corporate reorganization, which we refer to in this report as the proposed corporate reorganization, will occur immediately prior to such offering pursuant to which a wholly owned subsidiary of MagnaChip Semiconductor Corporation will be merged with and into MagnaChip Semiconductor LLC, after which MagnaChip Semiconductor LLC will become a wholly owned subsidiary of MagnaChip Semiconductor Corporation. Pursuant to the proposed corporate reorganization, all of the outstanding common units of MagnaChip Semiconductor LLC will be exchanged for shares of MagnaChip Semiconductor Corporation common stock, all of the outstanding Series B preferred units of MagnaChip Semiconductor LLC will be exchanged at the option of the holder for either shares of MagnaChip Semiconductor Corporation Series B preferred stock or common stock, and all of the outstanding options to purchase common units of MagnaChip Semiconductor LLC will be exchanged into options to purchase shares of MagnaChip Semiconductor Corporation common stock. There can be no assurance that the proposed corporate reorganization or the proposed public offering will occur in the near future, or at all.

**Overview**

MagnaChip is 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. We believe we have one of the broadest and deepest analog and mixed-signal semiconductor technology platforms in the industry, supported by our 28-year operating history, large portfolio of approximately 6,100 novel registered and pending patents and extensive engineering and manufacturing process expertise. Our wide variety of analog and mixed-signal semiconductor products and services combined with our deep technology platform allows us to address multiple high growth end markets and to develop and introduce new products quickly. Our substantial manufacturing operations in Korea and design centers in Korea and Japan provide us with proximity to the global consumer electronics supply chain. We believe this enables us to quickly respond to our customers' needs and allows us to better service and capture additional demand from existing and new customers.

We have a long history of supplying and collaborating on product and technology development with leading innovators in the consumer electronics market. Some of our largest customers by revenue include LG.Philips LCD Co., Ltd., Sharp Corporation and members of the Samsung group. We sold over 2,250 distinct products to over 200 customers in the year ended December 31, 2007, with a substantial portion of our revenues nonetheless derived from a concentrated number of customers, including LG.Philips LCD, Sharp and Samsung. Our largest semiconductor manufacturing services customers include some of the fastest growing and leading semiconductor companies that design products for the consumer, computing, wireless and industrial end markets. As a result, we have been able to strengthen our technology platform and focus on products and services that are in high demand by our customers and end consumers.

Our business was named MagnaChip Semiconductor when it was acquired from Hynix Semiconductor, Inc., or Hynix, in October 2004 by Citigroup Venture Capital Equity Partners, L.P., Francisco Partners L.P., certain investment funds advised by CVC Asia Pacific Limited or its affiliates, certain members of management and other investors. In this report, we refer to these entities as Court Square, Francisco Partners and CVC Asia Pacific and, collectively, as the sponsors and to this acquisition as the Original Acquisition.



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### **Market Opportunity**

The consumer electronics market is large and growing rapidly. This market includes mobile communications and entertainment devices such as digital televisions, mobile phones, flat panel displays, notebook computers, mobile multimedia devices and digital cameras. We believe that we address market segments with a higher growth rate than the overall consumer electronics market. For example, from 2006 to 2011 the worldwide third-generation mobile phone, liquid crystal display, or LCD, television and notebook computer market segments are expected to grow at compound annual unit growth rates of 28%, 27% and 24%, respectively, according to Gartner. We believe this growth will be driven largely by consumers seeking to enjoy greater availability of rich media content, such as digital and high definition audio and video, mobile television, games and digital photography. In order to address and further stimulate consumer demand, electronics manufacturers have been driving rapid advances in technology, functionality, form factor, cost, quality, reliability and power consumption of electronic devices. With these technological advancements, many electronic devices now display high resolution content, capture images, play digital audio and video and use power efficiently.

We believe that consumer electronics manufacturers recognize that the user experience plays a critical role in differentiating their products from competing offerings. This user experience is defined in part by the quality of the display, audio and video processing capabilities and power efficiency of a particular electronic product. Analog and mixed-signal semiconductors enable and enhance these device capabilities. Examples of such analog and mixed-signal semiconductors include display drivers, timing controllers, image sensors, power management voltage regulators, converters, audio coding or decoding devices, or codecs, interface circuits and radio frequency, or RF, components. According to iSuppli Corporation the market opportunity for semiconductors used in consumer electronics, wireless communications and data processing applications is expected to rise to \$260 billion in 2010, of which we believe we will have an addressable market opportunity of \$63 billion.

Design and manufacture of analog and mixed-signal semiconductors used in consumer electronics are highly complex. In order to grow and succeed in the industry, we believe semiconductor suppliers need to have a broad, advanced intellectual property portfolio, product design expertise, comprehensive product offerings and specialized manufacturing process technologies and capabilities.

### **Challenges Facing Our Customers**

We believe our target customers are looking for suppliers of analog and mixed-signal semiconductor products and services who can help them:

*Differentiate products through advanced features and functions.* Our target customers seek to differentiate their end products by employing innovative semiconductor products. They seek to closely collaborate with semiconductor suppliers that can provide advanced products, technologies, and manufacturing processes that enable advanced features and functions, such as bright and thin displays, small form factor and energy efficiency.

*Accelerate new product introduction.* As a result of rapid technological advancements and short product lifecycles, our target customers typically prefer suppliers who have a rich pipeline of new products and can leverage a substantial intellectual property and technology base to accelerate product design and manufacturing when needed.

*Ensure speed and stability of supply.* Our customers often face rapid product adoption. Inability to meet this demand can dramatically impact their profitability and market share. As a result, they need suppliers who can increase production quickly and meet demand consistently through periods of constrained industry capacity.

*Provide environmentally friendly products.* Consumers increasingly seek environmentally friendly and energy efficient products. In addition, there is increasing regulatory focus on reducing energy consumption of electronic products. As a result, our customers are seeking analog and mixed-signal semiconductor suppliers that have the technological expertise to deliver solutions that satisfy these ever increasing regulatory and consumer demands.

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*Deliver cost competitive solutions.* Electronics manufacturers are under constant pressure to deliver cost competitive solutions. To accomplish this objective, they need strategic suppliers that have the ability to provide system-level solutions and more integrated products, a broad product offering at a range of price points and the design and manufacturing infrastructure and logistical support to deliver cost competitive products.

### **Our Competitive Strengths**

Our competitive strengths enable us to offer our customers solutions to solve their key challenges. We believe our strengths include:

*Leading analog and mixed-signal semiconductor technology platform.* We believe we have one of the broadest and deepest analog and mixed-signal semiconductor technology platforms in the industry. Our long operating history, large patent portfolio, extensive engineering and manufacturing process expertise and wide selection of analog and mixed-signal intellectual property libraries allow us to leverage our technology across multiple end markets. This, in turn, allows us to develop and introduce new products quickly as well as to integrate numerous functions into a single product. For example, we were one of the first companies to introduce a commercial active matrix organic light emitting diode, or AMOLED, display driver for mobile phones. Further, we have introduced an integrated image sensor with digital auto focus technology, combining signal processing capabilities with specialized optics to achieve superior system performance in a single chip solution.

*Established relationships and close collaboration with leading global electronics companies.* We have a long history of supplying and collaborating on product and technology development with leading innovators in the consumer electronics market, such as LG.Philips LCD, Sharp and Samsung. As a result, we have further strengthened our technology platform and focus on those products and services that our customers and end consumers demand. We believe our close contact with customers enhances our visibility into new product opportunities, markets and technology trends.

*Comprehensive product and service offerings.* We continue to develop a wide variety of analog and mixed-signal semiconductor solutions for multiple high growth consumer end markets. We believe our expanding product and service offerings allow us to provide additional products to new and existing customers and to cross-sell our products and services to our established customers.

*Distinctive process technology expertise and manufacturing capabilities.* We have developed specialty analog and mixed-signal manufacturing processes such as high voltage complementary metal oxide semiconductor, or CMOS, power and embedded memory. These processes enable us to manufacture highly integrated, high performance analog and mixed-signal semiconductors. As a result of the depth of our process technology, captive manufacturing facilities and customer support capabilities, we believe the majority of our top twenty manufacturing services customers by revenue currently use us as their primary manufacturing source for the products that we manufacture for them.

*Longstanding presence in Asia.* Our substantial manufacturing operations in Korea and design centers in Korea and Japan provide proximity to many of our largest customers and to the core of the global consumer electronics supply chain. We have active local applications, engineering and product design support as well as senior management and marketing resources in geographic locations close to our customers. This allows us to strengthen our relationship with customers through better service, faster turnaround time and improved product design collaboration. We believe this also helps our customers to deliver products faster than their competitors and to solve problems more efficiently than would be possible with other suppliers.

*Highly efficient manufacturing capabilities.* Our manufacturing strategy is focused on maintaining the price competitiveness of our products and services through our low cost operating structure. We believe the location of our primary manufacturing and research and development facilities in Asia provides us with a number of cost advantages as compared to operating in other regions in the world.

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We offer specialty analog process technologies that do not require substantial investment in leading edge, smaller geometry process equipment. We are able to utilize our manufacturing base over an extended period of time and thereby minimize our capital expenditure requirements. Our internal manufacturing facilities serve both our solutions products and manufacturing services customers, allowing us to optimize our asset utilization and improve our operational efficiency.

### **Our Strategy**

Our objective is to grow our business and enhance our position as a leading provider of analog and mixed-signal semiconductor products and services for high volume consumer applications. Our business strategy emphasizes the following key elements:

*Leverage our leading analog and mixed-signal technology platform.* We intend to continue to utilize our extensive patent and technology portfolio and specific end-market applications expertise to deliver products with high levels of performance and integration to customers. We also intend to utilize our systems expertise to extend our product and service offerings within our target end markets. For example, we have utilized our extensive patent portfolio, process technologies and analog and mixed-signal technology platform to develop power management solutions that we expect will expand our market opportunity and address more of our customers' needs.

*Continue to innovate and deliver new products and services.* We intend to leverage our deep knowledge of our customers' needs, as well as our analog and mixed-signal design and manufacturing expertise, to design and develop innovative products and offer specialized manufacturing services. We continue to invest in research and development to introduce new technologies such as AMOLED display drivers. We are also currently developing innovative image sensors featuring backside illumination technology that we expect will offer improved light sensitivity performance at high resolutions. In manufacturing services, we are developing cost-effective processes that substantially reduce die size using deep trench isolation.

*Increase business with existing customers.* We have a global customer base consisting of leading consumer electronics original equipment manufacturers, or OEMs, who sell into multiple end markets. We intend to continue strengthening our relationships with our customers by collaborating on critical design and product development in order to improve our success in achieving design wins. We will seek to increase our customer penetration by taking advantage of our broad product portfolio and existing relationships to sell more existing and new products. For example, after initially providing image sensors to one of our key customers, we now also provide mobile and large display driver solutions and plan to provide additional solutions, such as power management, over time.

*Broaden our customer base.* We expect to continue to expand our global design centers, local application engineering support and sales presence, particularly in China, Hong Kong, Taiwan and Macau, or collectively, Greater China, and other high growth geographies, to penetrate new accounts. In addition, we intend to introduce new products and variations of existing products to address a broader customer base. For example, while we are initially targeting our existing customers with power management solutions, we expect to access a variety of distribution channels to broaden the customer base for these solutions over time.

*Drive execution excellence.* We have significantly improved our execution through a number of management initiatives implemented since the hiring of our Chief Executive Officer and Chairman, Sang Park, in 2006. As an example, we have introduced new processes for product development, customer service and personnel development. We expect these ongoing initiatives will improve our new product development and customer service as well as lead to a culture of quick action and execution by our workforce. As a result of our focus on execution excellence, we have meaningfully reduced our time from new product definition to development completion, and the proportion of our revenue derived from products introduced in the prior twelve months was approximately 33% greater during the year ended December 31, 2007 than in the comparable period of 2006.

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*Optimize asset utilization and return on capital investments.* We intend to keep our capital expenditures relatively low by maintaining our focus on specialty process technologies that do not require substantial investment in leading edge manufacturing equipment. By utilizing our manufacturing facilities for both our solutions products and our manufacturing services customers, we will seek to optimize returns on our capital investments.

### **Our Technology**

We continuously strengthen our leading analog and mixed-signal semiconductor technology platform by developing innovative technologies that enhance the functionality of consumer electronics products through brighter displays, enhanced image quality, smaller form factor and longer battery life. We seek to further build our technology platform through proprietary research and development and selective licensing and acquisition of complementary technologies, as well as disciplined process improvements in our manufacturing operations. Our goal is to leverage our experience and development initiatives across multiple end markets and utilize our understanding of system-level issues our customers face to introduce new technologies that enable our customers to develop more advanced, higher performance products.

Our display technology portfolio includes building blocks for display drivers and timing controllers, processor and interface technologies, as well as sophisticated production techniques, such as chip-on-glass, or COG, which enables the manufacture of thinner displays. Our advanced display drivers incorporate low temperature polysilicon, or LTPS, and AMOLED panel technologies that enable the highest resolution displays. Furthermore, we are developing a robust intellectual property portfolio to improve the power efficiency of displays, for example, our smart mobile luminance control, or SMLC, algorithm.

Our image sensor technology portfolio and development are centered on advanced pixel technologies and specialized manufacturing processes that increase light sensitivity and enable more integrated, thinner form factor image sensors. Our technology portfolio includes advanced algorithms, such as extended depth of field, or eDoF, and digital auto focus that enable significant image quality improvements.

We have a long history of specialized process technology development and have a number of distinctive process implementations. We have over 170 process flows we can utilize for our products and offer to our semiconductor manufacturing services customers. Our process technologies include standard CMOS, high voltage complementary metal-oxide semiconductor, or HVCMOS, ultra-low leakage HVCMOS, and bipolar complementary double-diffused metal oxide semiconductor, or BCDMOS. Our manufacturing processes incorporate embedded memory solutions such as static random access memory, or SRAM, one-time programmable, or OTP, memory, electronically erasable programmable read only memory, or EEPROM, and single-transistor random access memory, or 1TRAM. More broadly, we focus extensively on processes that reduce die size across all of the products we manufacture, in order to deliver cost effective solutions to our customers.

Expertise in high voltage and deep trench CMOS process technologies, low power analog and mixed-signal design capabilities and packaging know-how are key requirements in the power management market. We are currently leveraging our capabilities in these areas to enter the power management market with products such as DC-DC converters, linear regulators, including linear low drop out, or LDO, regulators and analog switches, and power metal oxide semiconductor field effect transistors, or MOSFETs. We believe our system level understanding of applications such as LCD TVs and mobile phones will allow us to more quickly develop and customize power management solutions for our customers in these markets.

### **Our Products and Services**

Our broad portfolio of products and services addresses multiple high growth, consumer-focused end markets. A key component of our product strategy is to supply multiple related product and service offerings to each of the end markets that we serve.

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### **Display Solutions**

*Display Driver Characteristics.* Display drivers deliver defined analog voltages and currents that activate pixels to exhibit images on displays. The following key characteristics determine display driver performance and end-market application:

*Resolution and Number of Channels.* Resolution determines the level of detail displayed within an image and is defined by the number of pixels per line multiplied by the number of lines on a display. For large displays, higher resolution typically requires more display drivers for each panel. Display drivers that have a greater number of channels, however, generally require fewer display drivers for each panel and command a higher selling price per unit. Mobile displays, conversely, are typically single chip solutions designed to deliver a specific resolution. We cover resolutions ranging from QQVGA (160RGB x 120) to HVGA (320RGB x 480).

*Color Depth.* Color depth is the number of colors that can be displayed on a panel. For example, for TFT-LCD panels, 262 thousand colors are supported by 6-bit source drivers; 16 million colors are supported by 8-bit source drivers; and 1 billion colors are supported by 10-bit and 12-bit source drivers.

*Operational Voltage.* Display drivers are characterized by input and output voltages. Source drivers typically operate at input voltages from 2.0 to 3.6 volts and output voltages between 4.5 and 18 volts. Gate drivers typically operate at input voltages from 2.0 to 3.6 volts and output voltages of up to 40 volts. Lower input voltage results in lower power consumption and electromagnetic interference, or EMI.

*Gamma Curve.* The relationship between the light passing through a pixel and the voltage applied to the pixel by the source driver is referred to as the gamma curve. The gamma curve of the source driver can correct some imperfections in picture quality in a process generally known as gamma correction. Some advanced display drivers feature up to three independent gamma curves to facilitate this correction.

*Driver Interface.* Driver interface refers to the connection between the timing controller and the display drivers. Display drivers increasingly require higher bandwidth interface technology to address the larger data transfer rate necessary for higher definition images. The principal types of interface technologies are transistor-to-transistor logic, or TTL, reduced swing differential signaling, or RSDS, low current differential signaling, or LCDS, and mini-low voltage differential signaling, or mLVDS.

*Package Type.* The assembly of display drivers typically uses chip-on-film, or COF, tape carrier package, or TCP, and COG package types.

*Mobile Display Solutions.* Our mobile display solutions incorporate the industry's most advanced display technologies, such as LTPS and AMOLED, as well as high volume technologies such as amorphous silicon, a-Si, TFT. Our mobile display products offer specialized capabilities, including high speed serial interfaces, such as mobile display digital interface, or MDDI, and mobile industry processor interface, or MIPI, as well as multi-time programmable, or MTP, memories, using EEPROM and logic-based OTP memory. Further, we are building a distinctive intellectual property portfolio that allows us to provide features that reduce power consumption, such as smart mobile luminance control, or SMLC, ambient light-based brightness control, or LABC, automatic brightness control, or ABC, and automatic current limit, or ACL. This intellectual property portfolio will also support our power management product development initiatives, as we leverage our system level understanding of power efficiency.

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The following table summarizes the features of our products, both in mass production and in development, for mobile displays:

<b>Product</b>	<b>Key Features</b>	<b>Applications</b>
LTPS	Resolutions of QQVGA, QCIF+, QVGA, WQVGA	Mobile phones
	Color depth ranging from 65 thousand to 16 million	PDA's
	Geometries of 0.13µm to 0.18µm	Digital cameras
	MDDI interface	
	MTP (EEPROM and logic-based OTP)	
AMOLED	Resolutions of QVGA, WQVGA	Mobile phones
	Color depth ranging from 262 thousand to 16 million	Portable multimedia players
	Geometries of 0.13µm to 0.15µm	PDA's
	MDDI interface	
	MTP (EEPROM and logic-based OTP)	
a-Si TFT	ABC, ACL	
	Resolutions of QCIF+, QVGA, WQVGA, HVGA	Mobile phones
	Color depth ranging from 262 thousand to 16 million	Game consoles
	Geometries of 0.13µm to 0.35µm	Navigation devices
	MDDI, MIPI Interface	
	1T RAM and MTP (EEPROM and logic-based OTP)	
	ABC, SMLC and LABC	
	Embedded touch screen controller	
Wide view angle support		
	Separated gamma control	

*Large Display Solutions.* We provide display solutions for a wide range of large panel display sizes used in digital televisions, including high definition televisions, or HDTVs, LCD monitors and notebook computers.

Our large display solutions include source and gate drivers and timing controllers with a variety of interfaces, voltages, frequencies and packages to meet customers' needs. These products include advanced technologies such as high channel count, with products under development to provide up to 720 channels. We also offer a distinctive interface technology known as LCDS, which supports thinner displays for notebook computers. Our large display solutions are designed to allow customers to cost effectively meet the increasing demand for high resolution displays. We focus extensively on reducing the die size of our large display drivers and other solutions products and have recently introduced a number of new large display drivers with reduced die size.

The table below sets forth the features of our products, both in mass production and in development, for large-sized displays:

<b>Product</b>	<b>Key Features</b>	<b>Applications</b>
TFT-LCD Source Drivers	384 to 720 output channels	LCD monitors, including widescreens
	6-bit (262 thousand colors), 8-bit (16 million colors), 10-bit and 12-bit (1 billion colors)	Notebook computers
	Output voltage ranging from 4.5V to 18V	Digital televisions, including HDTVs
	Input voltage ranging from standard 2.0V to 3.6V	
	Low power consumption and low EMI	
	Supports COF, TCP and COG package types	
	Supports RSDS, LCDS, and mLVDS interface technologies	
	Geometries of 0.18 $\mu$ m to 0.3 $\mu$ m	

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<b>Product</b>	<b>Key Features</b>	<b>Applications</b>
TFT-LCD Gate Drivers	240 to 540 output channels Output voltage ranging up to 40V Input voltage ranging from standard 2.0V to 3.6V Supports COF and COG package types Geometries of 0.35 $\mu$ m to 0.6 $\mu$ m	LCD monitors, including widescreens  Notebook computers  Digital televisions, including HDTVs
Timing Controllers	Product portfolio supports a wide range of resolutions Supports TTL, mLVDS, RSDS, LCDS interface technologies Input voltage ranging from 3.6V to 2.3V Geometries of 0.25 $\mu$ m to 0.6 $\mu$ m	LCD monitors  Notebook computers

**Power Solutions**

We have begun marketing a new line of power management solutions. Our initial power management products include MOSFETs, DC-DC converters and linear regulators, such as LDOs and analog switches. We have samples available, including a single LDO regulator, analog switch for USB 2.0, and both a 30 and 40-volt Trench MOSFET.

These initial products are designed for applications such as mobile phones and LCD televisions and allow electronics manufacturers to achieve specific design goals of high efficiency and low standby power consumption. For mobile device applications, our product design is focused on improving battery life, while for LCD televisions, we have focused our product design on controlling and reducing standby power consumption. We believe that our power management solutions will enable customers to increase system stability and reduce heat dissipation and energy use, resulting in cost savings for our customers and consumers, as well as environmental benefits.

Going forward, we expect to expand our power management product portfolio through the addition, for example, of more advanced DC-DC products. Our initial products are designed for production on our eight-inch manufacturing lines, which, in addition to increasing fab utilization, is expected to allow us to offer products at a competitive cost as compared to many currently available products. Further, we have begun building our direct and indirect sales network for our new power solutions to facilitate product distribution and have partnered with specialized packaging providers to deliver optimized, total solutions to our customers.

**Imaging Solutions**

We provide 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. Our captive manufacturing capabilities enable us to continuously refine our CMOS process and pixel technology to deliver improved image-capture sensitivity and accuracy.

Our CMOS image sensors are characterized by a high level of integration. Many CMOS image sensor systems are made up of at least two integrated circuits, including the CMOS image sensor itself and a separate image signal processor, or ISP. With the continuing demand for ever smaller camera-enabled devices, small size



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without performance degradation has become an increasingly important requirement for manufacturers of camera phones and similar products. Our products meet this demand for smaller form factor by integrating both our proprietary image sensor and an image signal processor, or ISP, onto a single chip, thus occupying approximately half of the space required by conventional multiple chip solutions, while providing equivalent, or even superior, image quality with lower power consumption and a lower overall cost.

The choice of image sensor products by our customers may involve many factors such as light sensitivity, resolution, size of device, packaging and integration level. Our image sensors are available in multiple package types as well as with various levels of integration, ranging from stand alone image sensors to SoC solutions that integrate ISP and eDoF technologies, so as to service a broad range of customer needs.

Image sensor products are classified by resolution, which determines the visual detail in the image. As the size of the pixel decreases, smaller devices can be produced with higher resolution. Image sensors are comprised of an array of pixels. The pixel size and optical format, which is the size of the image area, determine the size of the pixel array. Smaller optical formats and pixel sizes enable higher resolutions without increasing device size. Our image sensors range from VGA devices at one end of the resolution spectrum up to 3.2 MP at the other.

The table below sets forth the key products and features of our image solutions currently either in mass production or development.

<b>Resolution</b>	<b>Key Features</b>	<b>Applications</b>
VGA (640 x 480)	Pixel size: 5.04 $\mu$ m to 2.2 $\mu$ m	PC cameras
	Optical format: 1/4 to 1/10	Mobile phones
		Notebook computers
		Surveillance devices
1.3 MP (1280 x 1024)	Pixel size: 3.6 $\mu$ m to 2.8 $\mu$ m	Mobile phones
	Optical format: 1/3 to 1/5	Notebook computers
		Digital cameras
		Surveillance devices
2.1 MP (1600 x 1200)	Pixel size: 2.2 $\mu$ m	Mobile phones
	Optical format: 1/4	Notebook computers
3.2 MP (2048 x 1536)	Pixel size: 2.2 $\mu$ m to 1.75 $\mu$ m	Mobile phones
	Optical format: 1/3.2 to 1/4	Digital cameras

**Semiconductor Manufacturing Services**

We provide semiconductor manufacturing services to analog and mixed-signal semiconductor companies. We have over 170 process flows we offer 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. We refer to our approach of delivering specialized services to our customers as our application-specific technology, or AS Tech, strategy. We differentiate ourselves through the depth of our intellectual property portfolio, ability to customize process technology to meet the customers requirements effectively, long history in this business and reputation for excellence.

Our semiconductor manufacturing services customers typically serve high growth and high volume applications in the consumer, computing, wireless and industrial end markets. We strive to be the primary manufacturing source for our foundry customers.



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### Process Technology Overview

*Mixed-Signal.* Mixed-signal process technology is used in devices that require conversion of light and sound into electrical signals for processing and display. Our mixed-signal processes include advanced technologies such as triple gate, which uses less power at any given performance level.

*Power.* Power process technology, such as modular BCD, includes high voltage capabilities as well as the ability to integrate functionality such as self-regulation, internal protection, and other intelligent features.

*High Voltage CMOS.* High voltage CMOS process technology facilitates the use of high voltage levels in conjunction with smaller transistor sizes. This process technology includes several variations, such as bipolar processes, which use transistors with qualities well suited for amplifying and switching applications, mixed mode processes, which incorporate denser, more power efficient FETs and thick metal processes.

*Non-Volatile Memory (NVM).* Non-volatile memory process technology enables the integration of non-volatile memory cells that allow retention of the stored information even when power is removed from the circuit. This type of memory is typically used for long-term persistent storage.

*Microelectromechanical Systems (MEMS).* MEMS process technology allows the manufacture of components that use electrical energy to generate a mechanical response. For example, MEMS devices are used in the earpieces of mobile phones.

The table below sets forth the key process technologies in semiconductor manufacturing services currently in mass production or development.

Process	Technology	Device	End Markets
Mixed-signal	0.16-0.8 $\mu$ m	Analog to digital converter	Consumer
	Multipurpose	Digital to analog converter	Industrial
	Triple gate	CODEC	Wireless
		DVD chipset	Computing
Power	0.18-0.6 $\mu$ m	Power management	Consumer
	40V-80V	Power over Ethernet	Wireless
	Analog	LED drivers	Computing
	Modular BCD		
	BCD		
	Deep Trench		
	Trench MOSFET		
High Voltage CMOS	0.13-0.8 $\mu$ m	Display drivers	Consumer

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	18V-200V		Wireless
	Multiple options, such as Bipolar, Mixed Mode, Thick Metal		Computing
			Medical
NVM	0.18-0.35μm	Microcontroller	Consumer
	EEPROM	Electronic Tag	Industrial
	eFlash	Hearing aid	Medical
			Automotive
MEMS	1.0μm	Transducer	Wireless

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### **Sales and Marketing**

We focus our sales and marketing strategy on creating and strengthening our relationships with leading consumer electronics OEMs, such as LG.Philips LCD, Sharp and Samsung, as well as analog and mixed-signal semiconductor companies. We believe our close collaboration with customers allows us to align our product and process technology development with our customers' existing and future needs. Because our customers often service multiple end markets, our product sales teams are organized by customers as opposed to products. We believe this facilitates the sale of products that address multiple end-market applications to each of our customers. Our manufacturing services sales teams focus on marketing our services to mixed-signal semiconductor companies that require specialty manufacturing processes.

We sell our products through a direct sales force and a network of authorized agents and distributors. We have strategically located our sales and technical support offices near our customers. Our direct sales force consists primarily of representatives co-located with our design centers in Korea, Japan and the United States, as well as our local sales and support offices in Greater China and Europe. We have a network of agents and distributors in Korea, Japan, Europe and Greater China. During the year ended December 31, 2007, we derived approximately 83% of net sales through our direct sales force and 17% of net sales through our network of authorized agents and distributors.

### **Research and Development**

Our research and development efforts focus on intellectual property, design methodology and process technology for our complex analog and mixed-signal semiconductor products and services. Our expenditures for research and development were \$138.9 million, representing 17.5% of net sales for the year ended December 31, 2007, compared to 17.6% of net sales for the year ended December 31, 2006 and 11.5% of net sales for the year ended December 31, 2005.

### **Customers**

We sell our products to consumer electronics OEMs as well as subsystem designers and contract manufacturers. We sell our manufacturing services to analog and mixed-signal semiconductor companies. In the year ended December 31, 2007, our 10 largest customers accounted for approximately 58.9% of our net sales, and we had one customer, LG.Philips LCD, representing greater than 10% of our net sales. During the year ended December 31, 2007, we received revenues of \$47.3 million from customers in the United States and \$745.0 million from all foreign countries, of which 60.0% was from Korea, 16.6% from Taiwan, 9.8% from Japan and 9.1% from China, Hong Kong and Macau.

### **Intellectual Property**

As of December 31, 2007, our portfolio of intellectual property assets included approximately 6,100 novel registered and pending patents. Because we file patents in multiple jurisdictions, we additionally have approximately 1,400 registered and pending patents that relate to identical technical claims in our base patent portfolio. Our patents expire at various times over the next 18 years. While these patents are in the aggregate important to our competitive position, we do not believe that any single registered or pending patent is material to us.

We have entered into exclusive and non-exclusive licenses and development agreements with third parties relating to the use of intellectual property of the third parties in our products and our design processes, including licenses related to embedded memory technology, design tools, process simulation tools, circuit designs and processor cores. Some of these licenses, including our agreements with Silicon Works Co., Ltd. and ARM Limited, are material to our business and may be terminated prior to the expiration of these licenses by the licensors should we fail to cure any breach under such licenses. Additionally, in connection with the Original

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Acquisition, Hynix retained a perpetual license to use the intellectual property that we acquired from Hynix in the Original Acquisition. Under this license, Hynix and its subsidiaries are free to develop products that may incorporate or embody intellectual property developed by us prior to October 2004.

### **Competition**

We operate in highly competitive markets characterized by rapid technological change and continually advancing customer requirements. Although no one company competes with us in all of our product lines, we face significant competition in each of our market segments. Our competitors include other independent and captive manufacturers and designers of analog and mixed-signal integrated circuits including display driver, power management and image sensor semiconductor devices, as well as companies providing specialty manufacturing services.

We compete based on design experience, manufacturing capabilities, the ability to service customer needs from the design phase through the shipping of a completed product, length of design cycle and quality of technical support and sales personnel. Our ability to compete successfully will depend on internal and external variables, both within and outside of our control. These variables include the timeliness with which we can develop new products and technologies, product performance and quality, manufacturing yields, capacity availability, customer service, pricing, industry trends and general economic trends.

### **Employees**

Our worldwide workforce consisted of 3,605 employees (full- and part-time) as of December 31, 2007, of which 459 were involved in sales, general and administrative, 561 were in research and development (including 304 with advanced degrees), 90 were in quality, reliability and assurance and 2,495 were in manufacturing (comprised of 397 in engineering and 2,098 in operations). As of December 31, 2007, 2,185 employees, or approximately 61% of our workforce, were represented by the MagnaChip Semiconductor Labor Union, which is a member of the Federation of Korean Metal Workers Trade Unions. We believe our labor relations are good.

### **Environmental**

Our operations are subject to a variety of environmental, health and safety laws and regulations in each of the jurisdictions in which we operate, governing, among other things, air emissions, wastewater discharges, the generation, use, handling, storage and disposal of, and exposure to, hazardous substances (including asbestos) and waste, soil and groundwater contamination and employee health and safety. These laws and regulations are complex, constantly changing and have tended to become more stringent over time. There can be no assurance that we have been or will be in compliance with all these laws and regulations, or that we will not incur material costs or liabilities in connection with these laws and regulations in the future. The adoption of new environmental, health and safety laws, any 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.

### **Raw Materials**

We use processes that require specialized raw materials that are generally available from a limited number of suppliers. In 2006, we diversified suppliers for many of our raw materials, including polysilicon, chemicals, gases and tape. Tape is one of the process materials required for our display drivers. We continue to attempt to qualify additional suppliers for our raw materials.

For a description of our business and the distribution of our assets by geographic regions and reporting segments, see note 16 to the consolidated financial statements of MagnaChip Semiconductor LLC for the year ended December 31, 2007 elsewhere in this report.

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### **For More Information**

We are subject to the periodic reporting and other informational requirements of the Securities Exchange Act of 1934, as amended. You may read and copy any reports or other information filed by us at the SEC's public reference room at 100 F Street, N.E., Washington, DC 20549. Copies of this material can be obtained from the Public Reference Section of the SEC upon payment of fees prescribed by the SEC. You may call the SEC at 800-SEC-0350 for further information on the operation of the public reference room. Our filings will also be available to the public from commercial document retrieval services and at the SEC Web site at [www.sec.gov](http://www.sec.gov). In addition, you may request a copy of any of these filings, at no cost, by writing or telephoning us at the following address or phone number: c/o MagnaChip Semiconductor, Ltd., 891 Daechi-dong, Gangnam-gu, Seoul 135-738, Korea, Attention: Senior Vice President, General Counsel and Secretary; the telephone number at that address is 011-82-2-6903-3376.

### **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.

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### **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.

### **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 200 customers in the year ended December 31, 2007, net sales to our 10 largest customers represented approximately 58.9% of our net sales for the period. One customer represented greater than 10% of our net sales during the year ended December 31, 2007. 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;



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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.

### **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.

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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 have begun marketing a new line of power management solutions that we intend to sell to our customers 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 have begun 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.

### **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

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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 December 31, 2007, we had an accumulated deficit of approximately \$564.4 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 December 31, 2007, approximately 61% 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 original 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.

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### **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 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, withholding taxes, acquisition taxes, property and land use taxes and other taxes until December 31, 2008. 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.

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**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.

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 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

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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. 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.

### **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.

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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 December 31, 2007, our total indebtedness was approximately \$830 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 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.

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.





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### **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, 2008, 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 December 31, 2007, we recognized aggregate restructuring and impairment charges of \$142.6 million, which consisted of \$136.5 million of impairment charges and \$6.1 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.

### **Item 1B. Unresolved Staff Comments.**

Not Applicable.

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### **Item 2. Properties.**

Our manufacturing operations consist of two sites located in Cheongju and Gumi in Korea. These sites have a combined capacity of approximately 116,000 eight-inch equivalent wafers per month. We manufacture wafers utilizing geometries ranging from 0.13 to 1.0 micron. The Cheongju facilities have three main buildings totaling 164,058 square meters devoted to manufacturing and development. The Gumi facilities have one main building with 41,022 square meters devoted to manufacturing, testing and packaging.

In addition to our fabrication facilities located in Cheongju and Gumi, Korea, we lease facilities in Seoul, Korea, Sunnyvale, California, and Tokyo and Osaka, Japan. Each of these facilities includes administration, sales and marketing and research and development functions. We lease a design facility in Lake Oswego, Oregon, and sales and marketing offices at our subsidiaries in several other countries.

The ownership of our wafer manufacturing assets is an important component of our business strategy. Maintaining manufacturing control enables us to develop proprietary, differentiated products and results in higher production yields, as well as shortened design and production cycles. We believe our properties are adequate for the conduct of our business for the foreseeable future.

We use a combination of in-house and outsourced assembly, test and packaging services. Our independent providers of these services are located in Korea, China, Japan and Taiwan.

We are party to several building lease agreements, and land lease and easement agreements, with Hynix pursuant to which we lease certain of our facilities located in Cheongju, Korea to Hynix, and Hynix leases certain of its facilities to us. The lease terms are for twenty years from the date of the Original Acquisition with automatic extensions for ten year terms. However, the leases may be terminated by either party prior to the expiration of the terms upon the occurrence of a material breach by the other party or the cessation of business on the premises by the lessee, or by the lessee for any reason upon ninety days prior notice. Because we share certain facilities with Hynix, several services that are essential to our business are provided to us by or through Hynix under our general service supply agreement with Hynix. These services include electricity, bulk gasses and de-ionized water, campus facilities and housing, wastewater and sewage management, environmental safety and certain utilities and infrastructure support services. The services generally continue until the lease applicable to the property with respect to which the services are being provided terminates. However, certain of the services may be terminated by us prior to the applicable lease expiration. Hynix may also terminate this general service supply agreement upon a material breach by us or the cessation of business on the premises by us. Additionally, under a research and development equipment utilization agreement with Hynix, Hynix has granted us a right to use certain of its equipment for research and development purposes. The term of this agreement expires five years after the date of the Original Acquisition and may be extended for one additional year unless earlier terminated by either party upon the occurrence of a material breach by the other party. This agreement may also be terminated by Hynix if we cease to conduct certain permitted activities and, with respect to certain equipment, by us for any reason.

### **Item 3. Legal Proceedings.**

We are subject to lawsuits and claims that arise in the ordinary course of business and intellectual property litigation and infringement claims. Intellectual property litigation and infringement claims, in particular, could cause us to incur significant expenses or prevent us from selling our products. We are currently not involved in any legal proceedings the outcome of which we believe would have a material adverse effect on our business, financial condition or results of operations.

### **Item 4. Submission of Matters to a Vote of Security Holders.**

None.

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**PART II**

**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities.**

*Market Information*

There is currently no established public trading market for our outstanding common equity.

*Holdings*

The approximate number of record holders of our outstanding common units as of December 31, 2007 was 212.

*Dividends*

We did not pay any dividends in either fiscal year 2007 or 2006. Our ability to pay dividends is restricted by certain covenants contained in our senior credit facilities, as well as certain restrictions contained in our indentures relating to our senior notes and our subordinated notes.

*Equity Compensation Plan Information*

The information required by this item is incorporated by reference to the information set forth in Item 12 of this Annual Report on Form 10-K.

*Recent Sales of Unregistered Securities*

On December 24, 2007, one of our former executives exercised options to acquire 12,500 of our common units at a purchase price of \$37,500. 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.

**Item 6. Selected Financial Data.**

We have derived the selected consolidated financial and operating data below from the following sources:

The consolidated financial data as of and for the years ended December 31, 2007, 2006 and 2005, and the three months ended December 31, 2004 have been derived from the historical audited consolidated financial statements of MagnaChip Semiconductor LLC. The unaudited summary consolidated financial data include, in the opinion of our management, all adjustments, consisting only of normal recurring adjustments, that are necessary for a fair presentation of our financial position and results of operations for these periods. Prior to October 1, 2004, our consolidated financial statements were prepared on a carve-out basis from the consolidated financial statements and accounting records of Hynix using the actual results of operations and actual basis of assets and liabilities of our business.

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The selected consolidated financial and operating data below represent portions of our financial statements and are not complete. This information should be read together with Management's Discussion and Analysis of Financial Condition and Results of Operations and our consolidated financial statements and the related notes to these statements included in this report. Historical results are not necessarily indicative of future performance.

	Years ended December 31,			Three months ended	Nine months ended	Year ended
	2007	2006	2005	Dec. 31, 2004	Sept. 30, 2004	December 31, 2003
	Successor Company <sup>(1)</sup>					Predecessor Company <sup>(1)</sup>
	(Audited)					
	<i>(in millions, except per common unit data)</i>					
<b>Statement of Operations Data:</b>						
Net sales	\$ 792.4	\$ 744.4	\$ 937.7	\$ 243.6	\$ 841.6	\$ 830.8
Cost of sales	654.8	644.9	729.0	204.5	654.6	752.5
Gross profit	137.6	99.4	208.7	39.1	187.0	78.3
Selling, general and administrative	93.0	87.7	123.2	29.8	54.0	68.7
Research and development	138.9	131.3	107.6	22.1	75.7	86.6
Restructuring and impairment charges	12.1	94.3	36.2			
Operating income (loss)	(106.4)	(213.8)	(58.4)	(12.7)	57.4	(77.0)
Interest expense, net	60.3	57.2	57.2	16.8	17.7	37.8
Foreign currency gain (loss), net	(4.7)	50.9	16.5	30.4	5.4	1.4
Other					1.1	1.0
Other income (expenses)	(65.0)	(6.3)	(40.7)	13.6	(11.3)	(35.4)
Income (loss) before income taxes	(171.4)	(220.1)	(99.1)	0.9	46.1	(112.3)
Income tax expenses	9.1	9.3	1.8	6.7	2.8	1.4
Net income (loss)	\$ (180.6)	\$ (229.3)	\$ (100.9)	(5.8)	\$ 43.2	\$ (113.7)
Dividends accrued on preferred units	12.0	10.9	9.9	13.4		
Net (loss) attributable to common units	\$ (192.6)	\$ (240.2)	\$ (110.8)	\$ (19.3)		
Per unit data:						
Net (loss) per common unit:						
Basic and diluted	\$ (3.68)	\$ (4.54)	\$ (2.10)	\$ (0.38)		
Weighted-average units used in computing net (loss) per common unit:						
Basic and diluted	52.297	52.912	52.898	50.062		
<b>Balance Sheet Data (at period end):</b>						
Cash and cash equivalents	\$ 64.3	\$ 89.2	\$ 86.6	\$ 58.4	\$	\$
Total assets	707.9	770.1	1,040.6	1,154.5	653.8	790.0
Total indebtedness <sup>(2)</sup>	830.0	750.0	750.0	750.7	252.6	468.1
Preferred units	129.4	117.4	106.5	96.5		
Long-term obligations <sup>(3)</sup>	879.4	867.5	856.7	846.5	249.1	421.4
Owners' equity					206.7	155.3
Unitholders' equity	(477.5)	(284.5)	(46.5)	55.9		
<b>Supplemental Data:</b>						
EBITDA <sup>(4)</sup>	52.3	25.7	161.0	63.5	330.6	264.0

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Depreciation and amortization	163.4	188.6	202.9	45.9	266.9	338.5
Capital expenditures <sup>(5)</sup>	86.6	41.4	64.5	23.5	86.7	25.2
Net cash provided by (used in) operating activities	(23.7)	30.5	103.6	17.3	312.2	182.1
Net cash (used in) investing activities	(81.8)	(33.4)	(64.1)	(526.0)	(85.3)	(21.5)
Net cash provided by (used in) financing activities	80.1	(0.3)	(12.8)	10.0	(226.8)	(160.6)

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- (1) On October 6, 2004, our business was acquired from Hynix. For accounting purposes and consistent with its reporting periods, we have used October 1, 2004 as the effective date of such acquisition since the financial results from and after October 1, 2004 accrued to our benefit. As a result, we have reported our operating results and financial position for all periods from and after October 1, 2004 as those of the successor company. The predecessor company periods and the successor company periods have different bases of accounting and are therefore not comparable.
- (2) Total indebtedness is calculated as long- and short-term borrowings, including the current portion of long-term borrowings.
- (3) Long-term obligations include long-term borrowings, capital leases and redeemable preferred units.
- (4) EBITDA is defined as net income (loss) plus depreciation and amortization of intangible assets, interest expense, net and provision for income taxes. EBITDA is a key financial measure but should not be construed as an alternative to operating income, cash flows from operating activities or net income (loss), as determined in accordance with GAAP. EBITDA is not a measure defined in accordance with GAAP. We believe that EBITDA is a standard performance measure commonly reported and widely used by analysts and investors in our industry. However, the method of computation may or may not be comparable to other similarly titled measures of other companies. A reconciliation of net income (loss) to EBITDA is as follows:

	Years ended December 31,		
	2007	2006	2005
	<i>(in millions)</i>		
Net income (loss)	\$ (180.6)	\$ (229.3)	\$ (100.9)
Depreciation and amortization	163.4	188.6	202.9
Interest expense, net	60.3	57.2	57.2
Provision for income tax	9.1	9.3	1.8
<b>EBITDA</b>	<b>\$ 52.3</b>	<b>\$ 25.7</b>	<b>\$ 161.0</b>

- (5) Capital expenditures represent tangible and intangible asset acquisitions.

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### **Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with the audited consolidated financial statements and the related notes included elsewhere in this report. This discussion and analysis contains, in addition to historical information, forward-looking statements that include risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under the heading "Risk Factors" and elsewhere in this report.

#### **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 maintain 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.

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

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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.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 three separate business segments because we derive our revenues from three principal business lines: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. Additionally, we have a fourth operating segment, Power Solutions, from which we expect to begin earning revenues in 2008. 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 their designs, and we manufacture and sell the products to the customers based upon such designs. We offer over 170 process flows to our manufacturing services customers. We also often



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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.

### ***Revenue Sources***

*Net Sales.* We derive a majority of our sales (net of sales returns and allowances) from three reportable segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. Our non-segmented other net sales consist principally of rental and unit processing business activities. In unit processing, we execute a limited number of process steps, rather than the entire production sequence, in the manufacture of semiconductor wafers for one customer. Our product inventory is primarily located in Korea and is available for drop shipment globally. Outside of Korea, we maintain limited amounts of product inventory, and our sales representatives generally relay orders to our factories in Korea for fulfillment. We have strategically located our sales and technical support offices near concentrations of major customers. Our sales offices are located in Hong Kong, Japan, Korea, Taiwan, the United Kingdom and the United States. Our network of authorized agents and distributors consists of agents in the United States and Europe and distributors and agents in the Asia Pacific region.

We generally recognize revenue when risk and reward of ownership passes to the customer either upon shipment, upon product delivery at the customer's location or upon customer acceptance, depending on the terms of the arrangement. For the year ended December 31, 2007, we sold products to over 200 customers, and our net sales to our ten largest customers represented approximately 58.9% of our net sales. We have a combined production capacity of over 116,000 eight-inch equivalent semiconductor wafers per month. We believe our large-scale, cost-effective fabrication facilities enable us to rapidly adjust our production levels to meet shifts in demand by our end customers.

### ***Factors Affecting Our Results of Operations***

*Gross Profit.* Our overall gross profit generally fluctuates as a result of changes in overall sales volumes and in the average selling prices of our products and services. Other factors that influence our gross profit include changes in product mix, the introduction of new products and services and subsequent generations of existing products and services, shifts in the utilization of our manufacturing facilities and the yields achieved by our manufacturing operations, changes in material, labor and other manufacturing costs and variation in depreciation expense.

*Material Costs.* Our cost of sales consists of costs of raw materials, such as silicon wafers, chemicals, gasses and tape, packaging supplies, equipment maintenance and depreciation expenses. We use processes that require specialized raw materials, such as silicon wafers, that are generally available from a limited number of suppliers. If demand increases or supplies decrease, the costs of our raw materials could significantly increase. For example, worldwide supplies of silicon wafers, an important raw material for the semiconductors we manufacture, have been constrained in recent years due to an increased demand for polysilicon. Polysilicon is also a key raw material for solar cells, the demand for which has steadily increased over the last two years. We do not expect these supplies to increase significantly in the near future. In 2006, we diversified suppliers for many of our raw materials, including chemicals, gasses and tape, which is one of the process materials for our display drivers.

*Labor Costs.* A significant portion of our employees are located in Korea. Under Korean labor laws, 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 December 31, 2007, 95% of our employees were eligible for severance benefits. In accordance with the National Pension Act of Korea, a

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certain portion of accrued severance benefits is deposited with the National Pension Fund and deducted from the accrued severance benefits. The contributed amount is refunded to employees from the National Pension Fund upon their retirement.

*Depreciation Expense.* We periodically evaluate the carrying amounts of long-lived assets, including property, plant and equipment and intangible assets, as well as the related depreciation periods. At December 31, 2007, we depreciated our property, plant and equipment using the straight-line method over the estimated useful lives of our assets. Depreciation rates vary from 30-40 years on buildings to five years for certain equipment and assets. Our evaluation of carrying values is based on various analyses including cash flow and profitability projections. If our projections indicate that future undiscounted cash flows are not sufficient to recover the carrying amounts of the related long-lived assets, the carrying amount of the assets is impaired and will be reduced, with the reduction charged to expense so that the carrying amount is equal to fair value.

*Selling Expenses.* We sell our products worldwide through a direct sales force as well as a network of sales agents and representatives to OEMs, including major branded customers and contract manufacturers, and indirectly through distributors. Selling expenses consist primarily of the personnel costs for the members of our direct sales force, a network of sales representatives and other costs of distribution. Personnel costs include base salary, benefits and incentive compensation. As incentive compensation is tied to various net sales goals, it will increase or decrease with net sales.

*General and Administrative Expenses.* General and administrative expenses consist of the costs of various corporate operations, including finance, legal, human resources and other administrative functions. These expenses primarily consist of payroll-related expenses, consulting and other professional fees and office facility-related expenses. Historically, our selling, general and administrative expenses have moved in correlation with changes in revenues, and we expect this trend to continue in the future.

*Research and Development.* The rapid technological change and product obsolescence that characterize our industry require us to make continuous investments in research and development. Product development time frames vary but, in general, we incur research and development costs one to two years before generating sales from the associated new products. Our research and development costs incurred as a percentage of the consolidated revenues and in total have increased since 2005. These expenses include personnel costs for members of our engineering workforce, cost of photomasks, silicon wafers and other non-recurring engineering charges related to product design. Additionally, we develop base-line process technology through experimentation and through the design and use of characterization wafers that help achieve commercially feasible yields for new products. The majority of research and development expenses are for process development that serves as a common technology platform for all of our product segments. Consequently, we do not allocate these expenses to individual segments. We expect to continue to increase our investments in research and development to develop additional products and expand our business.

*Restructuring and Impairment Charges.* We evaluate the recoverability of certain long-lived assets on a periodic basis or whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. In our efforts to improve our overall profitability in future periods, we have closed or impaired, and may in the future close or impair, facilities which are underutilized and which are no longer aligned with our long-term business goals.

*Interest Expense, Net.* Our interest expense is incurred to service our notes in the amount of \$750 million and drawings under our senior secured credit facility. At December 31, 2007, the notes bore interest at a weighted average interest rate of 7.98%. Drawings under our senior secured credit facility bore interest at December 31, 2007 at either three-month LIBOR plus 4.75% or ABR plus 3.75% and were minimally offset by interest income on cash balances. Of the \$750 million of total long-term borrowings, \$300 million consist of variable interest rate securities. Effective as of June 27, 2005, we entered into an interest rate swap agreement that converted the variable interest rate portion of our notes into a fixed interest rate of 7.34%. That arrangement

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will be in effect until the swap agreement expires on June 15, 2008. As a result of our proposed public offering and proposed repayment of outstanding indebtedness, we expect that our interest expense will decrease in amount and as a percentage of net sales.

*Foreign Currency Gain or Loss.* A substantial portion of our net foreign currency gain or loss relates to non-cash translation gain or loss recorded for intercompany borrowings at our Korea subsidiary that is denominated in U.S. dollars. This balance sheet item is affected by fluctuations in the exchange rate between the Korean won and U.S. dollar.

*Income Taxes.* We record our income taxes in each of the tax jurisdictions in which we operate. This process involves using an asset and liability approach whereby deferred tax assets and liabilities are recorded for differences in the financial reporting bases and tax bases of our assets and liabilities. We exercise significant management judgment in determining our provision for income taxes, deferred tax assets and liabilities. We periodically evaluate our deferred tax assets to ascertain whether it is more likely than not that the deferred tax assets will be realized.

Our operations are subject to income and transaction taxes in Korea and in multiple foreign jurisdictions. Significant estimates and judgments are required in determining our worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result.

*Capital Expenditures.* We invest in manufacturing equipment, software design tools and other tangible and intangible assets for capacity expansion and technology improvement. Capacity expansions and technology improvements typically occur in anticipation of seasonal increases in demand. We typically pay for capital expenditures in partial installments with portions due on order, delivery and final acceptance.

*Inventories.* We monitor our inventory levels in light of product development changes and market expectations. We may be required to take additional charges for quantities in excess of demand, cost in excess of market value and product age. Our analysis may take into consideration historical usage, expected demand, anticipated sales price, new product development schedules, the effect new products might have on the sales of existing products, product age, customer design activity, customer concentration and other factors. These forecasts require us to estimate our ability to predict demand for current and future products and compare those estimates with our current inventory levels and inventory purchase commitments. Our forecasts for our inventory may differ from actual inventory use.

## **Basis of Presentation**

Our consolidated financial statements include the accounts of our company and our wholly owned subsidiaries. All significant intercompany transactions and balances are eliminated in consolidation.

*Segments.* Prior to our fiscal year 2006, we operated in a single segment semiconductor manufacturing. In fiscal year 2006, subsequent to the appointment of a new chief operating decision maker (the CODM) as defined by Statements of Financial Accounting Standards (SFAS) No. 131, *Disclosure about Segments of an Enterprise and Relate Information*, we changed the manner in which the CODM reviewed our operational results and made significant business decisions so as to include disaggregated financial information with respect to our three reportable segments. The segment information for prior periods has been prepared in conformity with our current segment structure.

**Table of Contents****Results of Operations**

The following table sets forth, for the periods indicated, certain information related to our operations, expressed in dollars and as a percentage of our net sales:

	2007		Years ended December 31, 2006		2005	
	Amount	% of net sales	Amount <i>(in millions; %)</i>	% of net sales	Amount	% of net sales
<b>Consolidated statement of operations data:</b>						
Net sales	\$ 792.4	100.0%	\$ 744.4	100.0%	\$ 937.7	100.0%
Cost of sales	654.8	82.6	644.9	86.6	729.0	77.7
Gross profit	137.6	17.4	99.4	13.4	208.7	22.3
Selling, general and administrative expenses	93.0	11.7	87.7	11.8	123.2	13.1
Research and development expenses	138.9	17.5	131.3	17.6	107.6	11.5
Restructuring and impairment charges	12.1	1.5	94.3	12.7	36.2	3.9
Operating income (loss)	(106.4)	(13.4)	(213.8)	(28.7)	(58.4)	(6.2)
Interest expense, net	60.3	7.6	57.2	7.7	57.2	6.1
Foreign currency gain (loss), net	(4.7)	(0.6)	50.9	6.8	16.5	1.8
Income (loss) before income taxes	(171.4)	(21.6)	(220.1)	(29.6)	(99.1)	(10.6)
Income tax expenses	9.1	1.2	9.3	1.2	1.8	0.2
Net income (loss)	(180.6)	(22.7)	(229.3)	(30.8)	(100.9)	(10.8)
<b>Net Sales:</b>						
Display Solutions	331.7	41.9	273.7	36.8	326.0	34.8
Imaging Solutions	82.9	10.5	60.5	8.1	163.3	17.4
Semiconductor Manufacturing Services	321.0	40.5	342.4	46.0	345.4	36.8
All other	56.8	7.2	67.8	9.1	102.9	11.0
	\$ 792.4	100.0%	\$ 744.4	100.0%	\$ 937.7	100.0%

**Table of Contents****Results of Operations Comparison of Years ended December 31, 2007 and December 31, 2006**

The following table sets forth consolidated results of operations for years ended December 31, 2007 and December 31, 2006:

	Year ended December 31, 2007		Year ended December 31, 2006		Change Amount
	Amount	% of net sales	Amount <i>(in millions; %)</i>	% of net sales	
Net sales	\$ 792.4	100.0%	\$ 744.4	100.0%	\$ 48.0
Cost of sales	654.8	82.6	644.9	86.6	9.9
Gross profit	137.6	17.4	99.4	13.4	38.2
Selling, general and administrative expenses	93.0	11.7	87.7	11.8	5.3
Research and development expenses	138.9	17.5	131.3	17.6	7.6
Restructuring and impairment charges	12.1	1.5	94.3	12.7	(82.2)
Operating income (loss)	(106.4)	(13.4)	(213.8)	(28.7)	107.4
Interest expense, net	60.3	7.6	57.2	7.7	3.1
Foreign currency gain, net	(4.7)	(0.6)	50.9	6.8	(55.6)
Income (loss) before income taxes	(171.4)	(21.6)	(220.1)	(29.6)	48.7
Income tax expenses	9.1	1.2	9.3	1.2	(0.2)
Net income (loss)	\$ (180.6)	(22.7)%	\$ (229.3)	(30.8)%	\$ 48.7

**Net Sales**

	Year ended December 31, 2007		Year ended December 31, 2006		Change Amount
	Amount	% of Total	Amount <i>(in millions; %)</i>	% of total	
Display Solutions	\$ 331.7	41.9%	\$ 273.7	36.8%	\$ 58.0
Imaging Solutions	82.9	10.5%	60.5	8.1	22.4
Semiconductor Manufacturing Services	321.0	40.5%	342.4	46.0	(21.4)
All other	56.8	7.2%	67.8	9.1	(11.0)
	\$ 792.4	100.0%	\$ 744.4	100.0%	\$ 48.0

Net sales for the year ended December 31, 2007 increased \$48.0 million, or 6.4% compared to the year ended December 31, 2006. Net sales generated in the three operating segments during the current year were \$735.6 million, an increase of \$59.0 million or 8.7% from the net sales of our three reportable segments for the prior-year period, primarily due to increased design wins and new account development, which contributed to market share gains. Among our segments, net sales increased \$58.0 million or 21.2% for our Display Solutions segment and a \$22.4 million or 37.0% for our Imaging Solutions segment. These increases were offset by a \$21.4 million or 6.2% decrease in sales from our Semiconductor Manufacturing Service segment. We believe that we will continue to experience profitable growth in future periods, although the overall trend in net sales will be subject to seasonal variations from quarter to quarter.

*Display Solutions.* Net sales from Display Solutions for the year ended December 31, 2007 were \$331.7 million, a \$58.0 million or 21.2% increase from \$273.7 million for the year ended December 31, 2006. The increase resulted from a 48.5% sales volume increase, primarily from

display driver products for LCD televisions, PC monitors and mobile devices. These increases in volume were partially offset by a 21.2% decrease in average selling prices. We believe that strong demand for display driver interfaces that manage

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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 \$22.4 million in the current year, or 37.0%, compared to net sales generated in the prior year. This increase resulted from a 179% sales volume increase, particularly of small form factor VGA products, and was partially offset by a 48.6% decrease in average selling prices.

*Semiconductor Manufacturing Services.* Net sales from Semiconductor Manufacturing Services for the year ended December 31, 2007 were \$321.0 million, a \$21.4 million, or a 6.2%, decrease compared to net sales of \$342.4 million for the year ended December 31, 2006. This decrease was primarily due to a 2.9% decrease in the average selling prices of our services of eight-inch equivalent wafers and to product program declines or terminations experienced by some of our key customers. In the fourth quarter of 2007, we entered into new services contracts with three European companies and continued to roll out our application-specific technology, or AS Tech, approach of delivering specialized services to create cost-effective solutions for our customers. We expect the results for our Semiconductor Manufacturing Services segment to remain stable or grow in 2008.

*All other.* Net sales from All other for the year ended December 31, 2007 were \$56.8 million compared to \$67.8 million for the year ended December 31, 2006. This decrease of \$11.0 million or 16.2% represents the revenue decrease from our unit processing service.

**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 year ended December 31, 2007 and December 31, 2006:

	Year ended December 31, 2007		Year ended December 31, 2006		
	Amount	% of Total	Amount	% of Total	
	<i>(in millions; %)</i>				
Korea	\$ 447.1	56.4%	\$ 413.7	55.6%	
Asia Pacific	193.8	24.5	173.0	23.2	
Japan	72.8	9.2	78.3	10.5	
North America	58.5	7.4	62.4	8.4	
Europe	20.2	2.5	17.0	2.3	
Total net revenues	\$ 792.4	100.0%	\$ 744.4	100.0%	

**Gross Profit**

	Year ended December 31, 2007		Year ended December 31, 2006		Change Amount
	Amount	% of net sales	Amount	% of net sales	
	<i>(in millions; %)</i>				
Display Solutions	\$ 41.5	12.5%	\$ 35.6	13.0%	\$ 5.9
Imaging Solutions	6.9	8.3	(4.0)	(6.6)	10.9
Semiconductor Manufacturing Services	67.1	20.9	45.7	13.4	21.4
All other	22.0	38.7	22.1	32.6	(0.1)
	\$ 137.6	17.4%	\$ 99.4	13.4%	\$ 38.2





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Total gross profit increased \$38.2 million in the year ended December 31, 2007, or 38.4%, compared to the gross profit generated in the year ended December 31, 2006. Gross profit percentage for the year ended December 31, 2007 was 17.4% of net sales, an increase of 4.0% from 13.4% for the year ended December 31, 2006. This increase in gross profit percentage was primarily attributable to an overall decrease in unit costs. The decreases in unit costs were driven by, among other factors, reduced depreciation expense, lower overhead costs on a per unit basis and a decline in materials prices. We expect our gross margin 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.

*Display Solutions.* Gross profit percentage for Display Solutions for the year ended December 31, 2007 slightly declined to 12.5% compared to 13.0% for the year ended December 31, 2006.

*Imaging Solutions.* Gross profit percentage for the current period improved compared to the prior-year period primarily due to a 179.1% increase in sales volume, a 57.8% decrease in unit cost of sales which resulted from an increase in overall production volume and a decrease in depreciation expense in connection with impairment charges in the second quarter of 2006, offset in part by a 48.6% decrease in average selling prices.

*Semiconductor Manufacturing Services.* Gross profit percentage for Semiconductor Manufacturing Services increased to 20.9% in the year ended December 31, 2007 from 13.4% in the year ended December 31, 2006. This increase was primarily due to a decrease in cost of sales, resulting from an overall increase in production volume.

*All other.* Gross profit percentage for All other for the current period increased to 38.7% from 32.6% for the prior-year period. This improvement in gross profit percentage was primarily attributable to an increase in sales volume for unit processing and lower fixed costs per unit. With respect to our new power management solutions business, we expect positive gross margin, as it will generate net sales from newly introduced products which should realize relatively higher average selling prices and benefit from efficient production process technology.

**Operating Expenses**

*Selling, General and Administrative Expenses.* Selling, general, and administrative expenses were \$93.0 million or 11.7% of net sales for the year ended December 31, 2007 compared to \$87.7 million or 11.8% for the year ended December 31, 2006. The increase of \$5.3 million or 6.0% from the prior-year period was attributable to an increase in salaries and various expense items, including a settlement with former subcontractors of \$1.3 million. These increases were partially offset by a \$1.1 million decrease in depreciation and amortization expenses.

*Research and Development Expenses.* Research and development expenses for the current period were \$138.9 million, an increase of \$7.6 million or 5.8% from \$131.3 million for the prior year period. This increase was mainly due to a \$5.3 million salary increase caused by an increase in staffing to support new product development. Research and development expenses as a percentage of net sales was 17.5%, virtually flat compared to 17.6% in the prior-year period. We expect research and development expenses in 2008 to be consistent generally with the levels of 2007 on a percentage of net sales basis.

*Restructuring and Impairment Charges.* During the year ended December 31, 2007, we recognized restructuring and impairment charges of \$12.1 million, which consisted of \$10.1 million of impairment charges under SFAS No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* ( SFAS No. 144 ) and \$2.0 million of restructuring charges under SFAS No. 146 *Accounting for Costs Associated with Exit or Disposal Activities* ( SFAS No. 146 ). The impairment charges recorded related to the closure of our five-inch wafer fabrication facility that has generated losses and no longer supports our strategic technology roadmap. This facility closing is expected to be completed within the first quarter of 2008.

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During the year ended December 31, 2006, we recorded restructuring and impairment charges totaling \$94.3 million, which included \$92.9 million of impairment charges under SFAS No. 144 and \$1.4 million of restructuring charges under SFAS No. 146.

The impairment charge of \$92.5 million recorded during 2006 related to certain fixed assets and technology and customer-based intangible assets (the asset group ) comprising our Imaging Solution business. At the end of 2005, the capacity utilization at our specialized fabrication facility was less than budgeted. This was primarily due to a transition in product mix, coupled with a seasonal decrease in market demand, which we deemed to be temporary and recoverable. However, in 2006, our management determined, based on revised forecasting, that projected demand for some of the products in our Imaging Solutions business was significantly less than previously forecasted and that this decline was not temporary or seasonal. Therefore, we assessed whether there had been an impairment of the asset group pursuant to SFAS No. 144 and, based on that assessment, recorded the impairment charge. We also recorded \$0.4 million of impairment charges in association with the disposition of certain held-for-sale assets.

The \$1.4 million of restructuring charges were incurred in connection with certain changes in our management and the early retirement of certain employees.

***Other Income (Expense)***

*Interest Expense, net.* Net interest expense was \$60.3 million during the year ended December 31, 2007, consistent with \$57.2 million for the year ended December 31, 2006. Interest expense was incurred to service our notes in the amount of \$750.0 million and drawings under our senior secured credit facility. At December 31, 2007, the notes bore interest at a weighted average interest rate of 7.98%. Drawings under our senior secured credit facility bore interest at December 31, 2007 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 year ended December 31, 2007 was \$4.7 million, compared to net foreign exchange gain of \$50.9 million for the year ended December 31, 2006.

A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss recorded for intercompany borrowings at our Korean subsidiary and is affected by changes in the exchange rate between the Korean won and the U.S. dollar. Foreign currency translation gain 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 respective maturity dates. The Korean won to U.S. dollar exchange rates were 935.8:1 and 930.0:1 using the noon buying rate in effect as of December 31, 2007 and December 31, 2006, respectively, as quoted by the Federal Reserve Bank of New York.

***Income Tax Expenses***

*Income Tax Expenses.* Income tax expenses for the current period were \$9.1 million, compared to income tax expenses of \$9.3 million for the same period of 2006. Income tax expense for 2007 was comprised of \$5.4 million of withholding taxes mostly paid on intercompany interest payments, \$3.4 million of current income taxes incurred in various jurisdictions in which we operate and a \$0.3 million income tax 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 tax assets.

**Table of Contents****Results of Operations Comparison of years ended December 31, 2006 and December 31, 2005**

	Year ended December 31, 2006		Year ended December 31, 2005		Change Amount
	Amount	% of net sales	Amount <i>(in millions; %)</i>	% of net sales	
Net sales	\$ 744.4	100.0%	\$ 937.7	100.0%	\$ (193.3)
Cost of sales	644.9	86.6	729.0	77.7	(84.1)
Gross profit	99.4	13.4	208.7	22.3	(109.3)
Selling, general and administrative expenses	87.7	11.8	123.2	13.1	(35.5)
Research and development expenses	131.3	17.6	107.6	11.5	23.7
Restructuring and impairment charges	94.3	12.7	36.2	3.9	58.1
Operating income (loss)	(213.8)	(28.7)	(58.4)	(6.2)	(155.4)
Interest expense, net	57.2	7.7	57.2	6.1	
Foreign currency gain, net	50.9	6.8	16.5	1.8	34.4
Income (loss) before income taxes	(220.1)	(29.6)	(99.1)	(10.6)	(121.0)
Income tax expenses	9.3	1.2	1.8	0.2	7.4
Net income (loss)	\$ (229.3)	(30.8)%	\$ (100.9)	(10.8)%	\$ (128.4)

**Net Sales**

	Year ended December 31, 2006		Year ended December 31, 2005		Change Amount
	Amount	% of total	Amount <i>(in millions; %)</i>	% of total	
Display Solutions	\$ 273.7	36.8%	\$ 326.0	34.8%	\$ (52.4)
Imaging Solutions	60.5	8.1	163.3	17.4	(102.8)
Semiconductor Manufacturing Services	342.4	46.0	345.4	36.8	(3.0)
All other	67.8	9.1	102.9	11.0	(35.1)
	\$ 744.4	100.0%	\$ 937.7	100.0%	\$ (193.3)

We derive a majority of our net sales from three reportable segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. All other for the period also included certain business activities exited in late 2005 or early 2006, such as our application processor and DRAM foundry businesses.

Total net sales for 2006 decreased \$193.3 million, or 20.6%, compared to 2005. Net sales generated from the three reportable segments in 2006 were \$676.6 million, a decrease of \$158.2 million, or 18.9%, from net sales from the three operating segments in 2005 mainly due to a \$102.8 million, or 63.0%, decrease in net sales from the Imaging Solutions segment and a \$52.4 million, or 16.0%, decrease in net sales from the Display Solutions segment.

*Display Solutions.* Net sales from Display Solutions for the year ended December 31, 2006 were \$273.7 million, a \$52.4 million, or a 16.1% decrease, from \$326.0 million for the year ended December 31, 2005. This decrease was primarily attributable to a 14.7% decline in average selling prices and a 1.6% sales volume decrease in large display driver products.

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*Imaging Solutions.* Imaging Solutions net sales decreased \$102.8 million in 2006, or 63%, compared to net sales generated in 2005. This decrease was primarily attributable to delays in transitioning to new megapixel

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products, resulting in a market share loss in this segment. Sales volume decreased by 37.8% due to lower market demand and average selling prices decreased by 36.2%.

*Semiconductor Manufacturing Services.* Net sales from Semiconductor Manufacturing Services for the year ended December 31, 2006 were \$342.4 million, a \$3.0 million or 0.9% decrease, compared to net sales of \$345.4 million for 2005. The decrease was attributable to a 14.8% decrease in the average selling prices of eight-inch equivalent wafers, partially offset by 11.0% sales volume increase.

*All other.* Net sales from All other for 2006 were \$67.8 million compared to \$102.9 million for 2005. This year-over-year sales reduction of \$35.1 million was caused by the exit of our application processor and DRAM foundry businesses which generated \$97.0 million of net sales in 2005, which were partially offset by a \$60.8 million increase in sales from unit processing due to entering into a new arrangement with the customer.

**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 each of the years ended December 31, 2006 and 2005:

	Year ended December 31, 2006		Year ended December 31, 2005	
	Amount	% of Total	Amount	% of Total
	<i>(in millions; %)</i>			
Korea	\$ 413.7	55.6%	\$ 512.4	54.6%
Asia Pacific	173.0	23.2	251.2	26.8
Japan	78.3	10.5	97.8	10.4
North America	62.4	8.4	56.9	6.1
Europe	17.0	2.3	19.4	2.1
Total net revenues	\$ 744.4	100.0%	\$ 937.7	100.0%

**Gross Profit**

	Year ended December 31, 2006		Year ended December 31, 2005		Change Amount
	Amount	% of net sales	Amount	% of net sales	
	<i>(in millions; %)</i>				
Display Solutions	\$ 35.6	13.0%	\$ 66.5	20.4%	\$ (30.9)
Imaging Solutions	(4.0)	(6.6)	25.4	15.6	(29.4)
Semiconductor Manufacturing Services	45.7	13.4	110.4	32.0	(64.7)
All other	22.1	32.6	6.3	6.1	15.8
	\$ 99.4	13.4%	\$ 208.7	22.3%	\$ (109.2)

Total gross profit decreased \$109.2 million in 2006, or 52.4%, compared to 2005. Gross profit percentage for 2006 was 13.4% of net sales, a decrease of 8.9% from 22.3% for 2005. This decline in gross profit percentage was primarily attributable to lower utilization of our manufacturing capacity as a result of substantial sales decreases, coupled with an overall decrease in average selling prices.

*Display Solutions.* Gross profit percentage for Display Solutions for the year ended December 31, 2006 declined to 13.0% compared to 20.4% for the year ended December 31, 2005. This decline in gross profit percentage was primarily attributable to a reduction of 14.7% in average selling prices from the previous year's average selling prices and to higher overhead cost per-unit driven by a decrease in unit volume.



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*Imaging Solutions.* Imaging Solutions reported a gross loss for the year ended December 31, 2006 primarily attributable to delays in transitioning to our new megapixel products and due to significant decreases in market demand for older products and a 36.2% decrease in average selling prices.

*Semiconductor Manufacturing Services.* Gross profit percentage for Semiconductor Manufacturing Services declined to 13.4% in 2006 from 32.0% in 2005. The year-over-year decrease was primarily attributable to manufacturing a higher mix of larger geometry wafers, which generate lower gross profits than smaller geometry wafers resulting in a 14.8% decrease in average selling prices.

*All other.* Gross profit percentage for All other for 2006 increased to 32.6% from 6.1% for the year ended December 31, 2005. This increase was mainly attributable to the discontinuation of the less profitable application processor and DRAM foundry businesses.

### ***Operating Expenses***

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$87.7 million or 11.8% of net sales for the year ended December 31, 2006 compared to \$123.2 million, or 13.1% of net sales, for the year ended December 31, 2005. This decrease of \$35.5 million, or 28.9%, from the prior year was primarily attributable to a \$13.3 million reduction in professional service fees driven by our cost containment efforts and a \$9.1 million decrease in amortization expense of intangible assets as a result of an impairment taken during the year.

*Research and Development Expenses.* Research and development expenses for the year ended December 31, 2006 were \$131.3 million, a \$23.7 million, or 21.9%, increase, from \$107.6 million for the year ended December 21, 2005. This increase in research and development expenses during the year primarily represented our focus on the introduction of new products. As a percentage of net sales, research and development expense increased to 17.6% in the more recent period as compared to 11.5% in the prior period.

*Restructuring and Impairment Charges.* During the year ended December 31, 2006, we recorded restructuring and impairment charges totaling \$94.3 million, which included \$92.9 million of impairment charges under SFAS No. 144 and \$1.4 million of restructuring charges under SFAS No. 146. The impairment charges of \$92.5 million recorded during 2006 related to certain fixed assets and technology and customer-based intangible assets (the asset group) comprising our Imaging Solution business. At the end of 2005, the capacity utilization at our specialized fabrication facility was less than budgeted. This was primarily due to a transition in product mix, coupled with a seasonal decrease in market demand, which we deemed to be temporary and recoverable. However, in 2006, our management determined, based on revised forecasting, that projected demand for some of the products in our Imaging Solutions business was significantly less than previously forecasted and that this decline was not temporary or seasonal. Therefore, we assessed whether there had been an impairment of the asset group pursuant to SFAS No. 144 and, based on that assessment, recorded the impairment charge. We also recorded \$0.4 million of impairment charges in association with the disposition of certain held-for-sale assets.

The \$1.4 million of restructuring charges were incurred in connection with certain changes in our management and the early retirement of certain employees.

During the year ended December 31, 2005, we recorded a one-time charge of \$36.2 million of restructuring and impairment charges which included \$33.5 million for asset impairment and \$2.7 million for restructuring.

### ***Other Income (Expense)***

*Interest Expense, net.* Net interest expense was \$57.2 million for the year ended December 31, 2006, consistent with \$57.2 million for the year ended December 31, 2005. Interest expense was incurred to serve our notes in the amount of \$750 million. At December 31, 2006, the notes bore interest at a weighted average interest rate of 7.4%.

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*Foreign Currency Gain, net.* Net foreign currency gain for the year ended December 31, 2006 was \$50.9 million, compared to \$16.5 for the year ended December 31, 2005. A substantial portion of our net foreign currency gain was non-cash translation gain recorded for intercompany borrowings at one of our subsidiaries and is affected by changes in the Korean won to U.S. dollar exchange rate. Foreign currency translation gain 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 have these intercompany borrowings repaid at their maturity dates. The Korean won to U.S. dollar exchange rates were 930.0:1 and 1,010.1:1 using the noon buying rate in effect as of December 31, 2006 and 2005, respectively, as quoted by the Federal Reserve Bank of New York.

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

Income tax expenses for the year ended December 31, 2006 were \$9.3 million while income tax expenses were \$1.8 million for the year ended December 31, 2005. The lower income tax expenses in the prior period were primarily attributable to the income tax benefit recognized for a temporary difference related to revenue recognition at our Japanese subsidiaries, which became recognizable as a result of a change in business model. Income tax expenses for 2006 were comprised of \$5.2 million of withholding taxes on the interest paid by one of our subsidiaries to its parent company, a \$2.0 million income tax effect from the decrease of deferred tax assets and an aggregate \$2.0 million of current income taxes incurred at various jurisdictions where we had our operations.

### **Liquidity and Capital Resources**

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 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 December 31, 2007, we had total long-term debt outstanding of \$750 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 December 31, 2007, our cash and cash equivalents balance were \$64.3 million, or 9.1%, of our total assets, a \$24.9 million decrease from \$89.2 million or 11.6% of total assets as of December 31, 2006. The decrease in cash and cash equivalents during the year ended December 31, 2007 was primarily attributable to a cash outflow of \$23.7 million in operating activities, coupled with a cash outflow related to capital expenditures during such period of \$86.6 million.

During the year ended December 31, 2007, net cash used in operating activities was \$23.7 million, compared to \$30.5 million of net cash generated by operating activities during the year ended December 31, 2006. This decrease in cash from operating activities between the two periods was primarily attributable to changes in operating assets and liabilities of \$41.8 million, mostly impacted by an increase in accounts receivable due to higher sales during the three-month period ended December 31, 2007, and increases in inventories primarily due to the anticipation of sales growth in future periods. These factors were offset by an increase of \$27.6 million in accounts payable as of December 31, 2007 compared to December 31, 2006 which was due to an increase in inventories purchased from third parties. The net operating cash outflow for the current period principally reflects our net loss of \$180.6 million adjusted by non-cash charges of \$198.7 million, which mainly consisted of depreciation, impairment and amortization charges and an increase in operating assets and liabilities of \$41.8 million.

Our working capital balance as of December 31, 2007 was \$55.6 million compared to \$122.6 million as of December 31, 2006. The decrease of \$67.0 million in our working capital balance was mainly due to a \$103.7 million increase in current liabilities, including an increase in short term borrowings of \$80 million, and a \$24.8



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million reduction in cash and cash equivalents which was used to support our capital investments and operations. This decrease was partially offset by an increase in accounts receivable of \$47.1 million and a build-up in inventory of \$18.0 million in anticipation of sales growth in future periods. We expect our working capital to remain consistent or decrease slightly from year-end 2007 amounts due to a variety of factors, including relatively stable accounts payable and the balance sheet impact of lower inventory valuation.

For investing activities, the net cash outlay during the year ended December 31, 2007 was \$81.8 million, compared to \$33.4 million in the prior-year period, primarily related to capacity expansion and technology improvements at a fabrication facility in anticipation of sales growth in future periods.

We generated \$80.1 million during the year ended December 31, 2007 from financing activities compared to the usage of \$0.3 million for the prior period ended December 31, 2006. During the year ended December 31, 2007, we borrowed \$130.1 million under our senior secured credit facility while we repaid borrowings under that facility of \$50.1 million during the same period. At December 31, 2007, we had borrowed \$80.0 million under our senior secured credit facility and had additional letters of credit of \$15.5 million issued under the facility.

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.

*Capital Expenditures.* For the year ended December 31, 2007, capital expenditures were \$86.6 million, a \$45.2 million or a 109.1% increase from \$41.4 million for the year ended December 31, 2006. This year-over-year increase was used to support capacity expansion and technology improvements at our fabrication facilities in anticipation of sales growth in future periods. We expect our capital expenditures to be approximately \$110 million in 2008, and we do not expect our capital budget to be affected in a material way by our entry into the power management solutions business.

*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 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, as well as to adjust for decreased demand during the Chinese New Year holiday. 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 December 31, 2007. 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	2008	Payments Due by Period				2012	Thereafter
			2009	2010	2011			
				<i>(in millions)</i>				
Senior secured credit facility <sup>(1)(2)</sup>	\$ 80.8	\$ 80.8	\$	\$	\$	\$	\$	\$
Notes <sup>(3)</sup>	1,047.5	59.8	59.8	59.8	558.7	20.0	289.4	
Operating lease	56.0	11.2	11.2	11.2	11.2	11.2		
Others	6.0	3.2	2.0	0.5	0.3			

(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 year ended December 31, 2007.

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<sup>7</sup>/<sub>8</sub>% 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 the senior secured credit facility waived certain provisions of the credit agreement to permit us to consummate the proposed corporate reorganization and the proposed public offering and to use the proceeds from the proposed public offering as described in the registration statement.

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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. As of the date of adoption, our unrecognized tax benefits totaled \$1.6 million. These unrecognized tax benefits have been excluded from the above table because we cannot estimate the period of cash settlement with the respective taxing authorities.

### **Off-Balance Sheet Arrangements**

On December 23, 2004, two of our subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company entered into a senior 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 December 31, 2007 and December 31, 2006 was \$4.5 million and \$93.8 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.

### **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* ( FAS 141R ), which replaces FASB Statement No. 141. FAS 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. FAS 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 FAS 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* ( FAS 160 ). FAS 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. FAS 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. FAS 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 FAS 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*, which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity 's first fiscal year beginning after November 15, 2007. We are currently evaluating the impact that the adoption may have on our consolidated financial statements.

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

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

The preparation of 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.

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.

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### ***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 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.

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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.

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 7A. 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.

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*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 December 31, 2007 for our Korean subsidiary, a 10% devaluation of the Korean won against the U.S. dollar would have resulted in a decrease of \$0.7 million in our U.S. dollar financial instruments balance and cash balance. Based on the Japanese yen cash balance at December 31, 2007, a 10% devaluation of the Japanese yen against the U.S. dollar would have resulted in a decrease of \$0.4 million 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 December 31, 2007, we estimate that we would have additional interest expense costs over the market rate of \$2.9 million (on a 360-day basis). The fair value of these fixed rate notes would have decreased by \$7.0 million or increased by \$7.3 million with a 10% increase or decrease in the interest rate, respectively.

*Cash Flow Interest Rate Risk.* In 2005, we entered into an interest rate swap agreement to convert the variable interest rate on our floating rate second priority senior secured notes to a fixed interest rate for the periods to maturity date of June 2008. Pursuant to this interest rate swap and during the duration of such swap, cash flow interest rate risk was replaced with exposure to interest rate risk.



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**Item 8. Financial Statements and Supplementary Data.**

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Unitholders of

MagnaChip Semiconductor LLC

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of changes in unitholders equity and of cash flows present fairly, in all material respects, the financial position of MagnaChip Semiconductor LLC and its subsidiaries (the Company ) at December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

/s/ Samil PricewaterhouseCoopers

Seoul, Korea  
January 30, 2008

**Table of Contents****MAGNACHIP SEMICONDUCTOR LLC AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

(In thousands of US dollars, except unit data)

	December 31, 2007	December 31, 2006
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 64,345	\$ 89,173
Accounts receivable, net	123,789	76,665
Inventories, net	75,867	57,846
Other receivables	5,771	6,754
Other current assets	10,951	13,626
<b>Total current assets</b>	<b>280,723</b>	<b>244,064</b>
Property, plant and equipment, net	279,669	336,279
Intangible assets, net	104,725	139,729
Other non-current assets	42,766	49,981
<b>Total assets</b>	<b>\$ 707,883</b>	<b>\$ 770,053</b>
<b>Liabilities and Unitholders Equity</b>		
Current liabilities		
Accounts payable	\$ 89,977	\$ 62,399
Other accounts payable	30,661	32,423
Accrued expenses	18,100	23,647
Short-term borrowings	80,000	
Other current liabilities	6,377	2,980
<b>Total current liabilities</b>	<b>225,115</b>	<b>121,449</b>
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	74,176	62,836
Other non-current liabilities	6,666	2,935
<b>Total liabilities</b>	<b>1,055,957</b>	<b>937,220</b>
Commitments and contingencies		
Series A redeemable convertible preferred units, \$1,000 par value; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at December 31, 2007 and 2006		
Series B redeemable convertible preferred units, \$1,000 par value; 550,000 units authorized, 450,692 units issued and 93,997 units outstanding at December 31, 2007 and 2006	129,405	117,374
<b>Total redeemable convertible preferred units</b>	<b>129,405</b>	<b>117,374</b>
Unitholders equity		
Common units, \$1 par value; 65,000,000 units authorized, 52,844,222 and 52,720,784 units issued and outstanding at December 31, 2007 and 2006, respectively	52,844	52,721
Additional paid-in capital	3,077	2,451
Accumulated deficit	(564,449)	(370,314)

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Accumulated other comprehensive income	31,049	30,601
Total unitholders' equity	(477,479)	(284,541)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ 707,883	\$ 770,053

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

**Table of Contents****MAGNACHIP SEMICONDUCTOR LLC AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands of US dollars, except unit data)**

	<b>December 31, 2007</b>	<b>Years ended December 31, 2006</b>	<b>December 31, 2005</b>
Net sales	\$ 792,356	\$ 744,352	\$ 937,656
Cost of sales	654,787	644,911	728,999
<b>Gross profit</b>	<b>137,569</b>	<b>99,441</b>	<b>208,657</b>
Selling, general and administrative expenses	92,990	87,677	123,211
Research and development expenses	138,863	131,252	107,590
Restructuring and impairment charges	12,084	94,266	36,234
<b>Operating income (loss)</b>	<b>(106,368)</b>	<b>(213,754)</b>	<b>(58,378)</b>
Other expenses			
Interest expense, net	(60,311)	(57,159)	(57,236)
Foreign currency gain (loss), net	(4,732)	50,861	16,532
	(65,043)	(6,298)	(40,704)
Income (loss) before income taxes	(171,411)	(220,052)	(99,082)
Income tax expenses	9,139	9,258	1,816
Net income (loss)	\$ (180,550)	\$ (229,310)	\$ (100,898)
Dividends accrued on preferred units	12,031	10,912	9,928
Net income (loss) attributable to common units	\$ (192,581)	\$ (240,222)	\$ (110,826)
Net income (loss) per common unit Basic and diluted	\$ (3.68)	\$ (4.54)	\$ (2.10)
Weighted average number of units Basic and diluted	52,297,192	52,911,734	52,898,497

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

**Table of Contents****MAGNACHIP SEMICONDUCTOR LLC AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN UNITHOLDERS EQUITY**

(In thousands of US dollars, except unit data)

	Common Units		Additional Paid-In Capital	Accumulated deficit	Accumulated Other Comprehensive Income (loss)	Total
	Units	Amount				
<b>Balance at January 1, 2005</b>	52,533,003	\$ 52,533	\$ 2,100	\$ (19,266)	\$ 20,505	\$ 55,872
Issuance of common units	504,317	504	10			514
Exercise of unit options	54,250	55	59			114
Dividends accrued on preferred units				(9,928)		(9,928)
Comprehensive income (loss):						
Net income (loss)				(100,898)		(100,898)
Fair valuation of derivatives					4,534	4,534
Foreign currency translation adjustments					3,308	3,308
<b>Total comprehensive income (loss)</b>						(93,056)
<b>Balance at December 31, 2005</b>	53,091,570	\$ 53,092	\$ 2,169	\$ (130,092)	\$ 28,347	\$ (46,484)
Exercise of unit options	46,062	46	42			88
Repurchase of common units	(416,848)	(417)	(3)			(420)
Unit-based compensation			243			243
Dividends accrued on preferred units				(10,912)		(10,912)
Comprehensive income (loss):						
Net income (loss)				(229,310)		(229,310)
Fair valuation of derivatives					(193)	(193)
Foreign currency translation adjustments					2,447	2,447
<b>Total comprehensive income (loss)</b>						(227,056)
<b>Balance at December 31, 2006</b>	52,720,784	\$ 52,721	\$ 2,451	\$ (370,314)	\$ 30,601	\$ (284,541)
Exercise of unit options	124,938	125	26			151
Repurchase of common units	(1,500)	(2)	(4)			(6)
Unit-based compensation			604			604
Dividends accrued on preferred units				(12,031)		(12,031)
Impact on beginning accumulated deficit upon adoption of FIN 48				(1,554)		(1,554)
Comprehensive income (loss):						
Net income (loss)				(180,550)		(180,550)
Fair valuation of derivatives					(3,477)	(3,477)
Foreign currency translation adjustments					3,925	3,925
<b>Total comprehensive income (loss)</b>						(180,102)
<b>Balance at December 31, 2007</b>	52,844,222	\$ 52,844	\$ 3,077	\$ (564,449)	\$ 31,049	\$ (477,479)

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

**Table of Contents****MAGNACHIP SEMICONDUCTOR LLC AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands of US dollars)

	2007	2006	2005
<b>Cash flows from operating activities</b>			
Net income (loss)	\$ (180,550)	\$ (229,310)	\$ (100,898)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities			
Depreciation and amortization	163,434	188,560	202,929
Provision for severance benefits	18,834	11,497	16,583
Amortization of debt issuance costs	3,919	3,701	3,432
Loss (gain) on foreign currency translation, net	5,398	(54,188)	(15,880)
Loss (gain) on disposal of property, plant and equipment, net	(68)	1,490	(829)
Impairment charges	10,106	92,858	33,576
Unit-based compensation	604	243	
Other	(3,579)	3,023	721
Changes in operating assets and liabilities			
Accounts receivable	(46,504)	44,091	(25,812)
Inventories	(18,398)	37,064	(806)
Other receivables	971	3,180	62,821
Deferred tax assets	952	1,954	(12,935)
Accounts payable	26,442	(38,423)	24,928
Other accounts payable	(6,021)	(15,897)	(66,069)
Accrued expenses	(5,504)	(7,453)	(5,184)
Other current assets	9,840	5,063	2,713
Other current liabilities	5,007	(7,329)	200
Payment of severance benefits	(7,151)	(8,589)	(13,831)
Other	(1,443)	(1,065)	(2,012)
Net cash provided by (used in) operating activities	(23,711)	30,470	103,647
<b>Cash flows from investing activities</b>			
Proceeds from disposal of plant, property and equipment	364	3,651	673
Proceeds from disposal of intangible assets	4,204	2,819	
Purchase of plant, property and equipment	(85,294)	(39,196)	(62,334)
Payment for intellectual property registration	(1,256)	(2,203)	(2,174)
Acquisition of business, net of cash acquired of \$4,620 for the year ended December 31, 2005			(11,749)
Decrease in restricted cash		3,002	10,307
Other	176	(1,458)	1,205
Net cash used in investing activities	(81,806)	(33,385)	(64,072)
<b>Cash flows from financing activities</b>			
Proceeds from short-term borrowings	130,100		
Issuance of common units	151	88	628
Repayment of short-term borrowings	(50,100)		(12,883)
Repurchase of common units	(6)	(420)	
Debt issuance costs paid			(594)
Net cash provided by (used in) financing activities	80,145	(332)	(12,849)
Effect of exchange rates on cash and cash equivalents	544	5,846	1,452



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Net increase (decrease) in cash and cash equivalents	(24,828)	2,599	28,178
<b>Cash and cash equivalents</b>			
Beginning of the year	89,173	86,574	58,396
End of the year	\$ 64,345	\$ 89,173	\$ 86,574
<b>Supplemental cash flow information</b>			
Cash paid for interest	\$ 57,468	\$ 56,025	\$ 53,373
Cash paid for income taxes	\$ 5,680	\$ 12,685	\$ 15,370

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

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### **MagnaChip Semiconductor LLC and Subsidiaries**

#### **Notes to Consolidated Financial Statements**

**(Tabular dollars in thousands, except unit data)**

## **1. General**

### **The Company**

MagnaChip Semiconductor LLC and its subsidiaries (the Company) is a designer, developer and manufacturer of mixed-signal and digital multimedia semiconductors addressing the convergence of consumer electronics and communication devices.

The Company operates in three segments Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. The Display Solutions segment offers flat panel display drivers for the entire product range of small to large panel displays, including mobile phones, digital cameras, photo printers, games, monitors, and LCD TVs. The Imaging Solutions segment addresses a broad spectrum of consumer electronics products ranging from camera-equipped mobile handsets to personal computer webcams, offering VGA, 1.3, 2.1 and 3.1 megapixel CMOS image sensors. The Semiconductor Manufacturing Services segment uses the Company's process technology and manufacturing facilities to manufacture semiconductor wafers for third parties based on their designs. The Company has five wafer fabrication facilities located in Cheongju and Gumi in the Republic of Korea.

MagnaChip Semiconductor LLC was created on November 26, 2003 and was capitalized on September 10, 2004 under the laws of the State of Delaware. It was created with the sole purpose of acquiring the non-memory business (the Business) of Hynix Semiconductor Inc. (Hynix), which acquisition was completed with effect from October 1, 2004 (the Original Acquisition).

## **2. Summary of Significant Accounting Policies**

### **Basis of Presentation**

The consolidated financial statements are presented in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP). Significant accounting policies followed by the Company in the preparation of the accompanying financial statements are summarized below.

### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company including its wholly-owned subsidiaries. All significant intercompany transactions and balances are eliminated in consolidation.

### **Use of Estimates**

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the accompanying financial statements and disclosures. The most significant estimates and assumptions relate to the useful life of property, plant and equipment, allowance for uncollectible accounts receivable, contingent liabilities, inventory valuation, restructuring accrual and impairment of long-lived assets. Although these estimates are based on management's best knowledge of current events and actions that the Company may undertake in the future, actual results may be different from the estimates.

### **Foreign Currency Translation**

The Company has assessed in accordance with Statements of Financial Accounting Standards (SFAS) No. 52, *Foreign Currency Translation*, the functional currency of each of its subsidiaries in Luxembourg, the

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

Netherlands and the United Kingdom and has designated the U.S. dollar to be their respective functional currencies. The Company and its other subsidiaries are utilizing their local currencies as their functional currencies. The financial statements of the subsidiaries in functional currencies other than the U.S. dollar are translated into the U.S. dollar in accordance with SFAS No. 52. All the assets and liabilities are translated to the U.S. dollar at the end-of-period exchange rates. Capital accounts are determined to be of a permanent nature and are therefore translated using historical exchange rates. Revenues and expenses are translated using average exchange rates. Foreign currency translation adjustments arising from differences in exchange rates from period to period are included in the foreign currency translation adjustment account in accumulated comprehensive income (loss) of unitholders' equity. Transactions in currencies other than the functional currency are included as a component of other income (expense) in the statement of operations.

**Cash and Cash Equivalents**

Cash equivalents consist of highly liquid investments with an original maturity date of three months or less.

**Accounts receivable reserves**

An allowance for doubtful accounts is provided based on the aggregate estimated collectibility of their accounts receivable. The Company records an allowance for cash returns, presented within accounts receivable, based on the historical experience of the amount of goods that will be returned and refunded. In addition, the Company also includes in accounts receivable, an allowance for additional products that may have to be provided, free of charge, to compensate customers for products that do not meet previously agreed yield criteria, the low yield compensative reserve.

**Inventories**

Inventories are stated at the lower of cost or market, using the average cost method, which approximates the first in, first out method ( FIFO ). If net realizable value is less than cost at the balance sheet date, the carrying amount is reduced to the realizable value, and the difference is recognized as a loss on valuation of inventories within cost of sales. Inventory reserves are established when conditions indicate that the net realizable value is less than costs due to physical deterioration, obsolescence, changes in price levels, or other causes based on individual facts and circumstances. Reserves are also established for excess inventory based on inventory levels in excess of six months of projected demand, as judged by management, for each specific product.

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

**Property, Plant and Equipment**

Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as set forth below.

Buildings	30 - 40 years
Building related structures	10 - 20 years
Machinery and equipment	5 - 10 years
Vehicles and others	5 years



## **Table of Contents**

### **MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

Routine maintenance and repairs are charged to expense as incurred. Expenditures that enhance the value or significantly extend the useful lives of the related assets are capitalized.

Borrowing costs incurred during the construction period of assets are capitalized as part of the related assets.

#### **Impairment of Long-Lived Assets**

The Company reviews property, plant and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Recoverability is measured by comparison of its carrying amount with the future net cash flows the assets are expected to generate. If such assets are considered to be impaired, the impairment is measured as the difference between the carrying value of the assets and the fair value of assets using the present value of the future net cash flows generated by the respective long-lived assets.

#### **Restructuring Charges**

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

#### **Lease Transactions**

The Company accounts for lease transactions as either operating leases or capital leases, depending on the terms of the underlying lease agreements. Machinery and equipment acquired under capital lease agreements are recorded at cost as property, plant and equipment and depreciated using the straight-line method over their estimated useful lives. In addition, the aggregate lease payments are recorded as capital lease obligations, net of unaccrued interest. Interest is amortized over the lease period using the effective interest rate method. Leases that do not qualify as capital leases are classified as operating leases, and the related rental payments are expensed on a straight-line basis over the lease term.

#### **Software**

The Company capitalizes certain external costs that are incurred to purchase and implement internal-use computer software. Direct costs relating to the development of software for internal use are capitalized after technological feasibility has been established, in accordance with Statement Of Position ( SOP ) No. 98-1, *Accounting for the Costs of Computer Software Developed or Obtained for Internal Use*. Depreciation is calculated on a straight line basis over five years.

#### **Intangible Assets**

Intangible assets acquired from Hynix include technology and customer relationships which are amortized on a straight-line basis over periods ranging from 4 to 8 years. Other intellectual property assets acquired represent rights under patents, trademarks and property use rights and are amortized over the periods of benefit, ranging up to 10 years, on a straight-line basis.

#### **Goodwill**

Goodwill is evaluated for impairment by computing the fair value and carrying value of the reporting unit to which the goodwill relates. Specifically, the Company uses the two-step method for evaluating goodwill for



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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

impairment as prescribed in SFAS No.142. In the first step, the fair value of a reporting unit is compared to the carrying amount of such reporting unit. If the carrying amount exceeds the fair value, a potential impairment condition exists. In the second step, impairment is measured as the excess of the carrying amount of reporting unit goodwill over the implied fair value of reporting unit goodwill. If the fair value of a reporting unit exceeds its carrying amount, goodwill of the reporting unit is considered not impaired, and thus the second step of the impairment test is unnecessary.

**Fair Value Disclosures of Financial Instruments**

The estimated fair value of financial instruments is determined by the Company, using available market information and valuation methodologies considered to be appropriate. However, considerable judgment is required in interpreting market data to develop the estimates of fair value. Carrying amounts of accounts receivable and accounts payable approximate fair value due to the short maturity of these financial instruments.

The estimated fair value of the Company's debt was \$614.5 million, \$612.6 million and \$738.8 million as of December 31, 2007, 2006 and 2005, respectively. The fair value estimates presented herein were based on market interest rates and other market information available to management as of each balance sheet date presented. The use of different market assumptions and/or estimation methodologies could have a material effect on the estimated fair value amounts. Approximate fair values do not take into consideration expenses that could be incurred in an actual settlement. Accordingly, the estimates presented herein are not necessarily indicative of the amounts that the Company could realize in a current market exchange.

**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 December 31, 2007, 95% of all employees of the Company were eligible for severance benefits.

Accrued severance benefits are funded through a group severance insurance plan. The amounts funded under this insurance plan are classified as a deduction to the accrued severance benefits. Subsequent accruals are to be funded at the discretion of the Company.

In accordance with the National Pension Act of the Republic of Korea, a certain portion of accrued severance benefits is deposited with the National Pension Fund and deducted from the accrued severance benefits. The contributed amount is refunded to employees from the National Pension Fund upon their retirement.

**Revenue Recognition**

Revenue is recognized 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 the resulting receivable is reasonably assured. Utilizing these criteria, product revenue is recognized either upon shipment, upon delivery of the product at the customer's location or upon customer acceptance, depending on the terms of the arrangements, when the risks and rewards of ownership have passed to the customer. The Company's customers can return defective products, including products that do not meet the yield criteria. The Company

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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

accrues for the estimated costs that may be incurred for the defective products. In addition, the Company offers early payment discounts to customers who make early payments. The Company estimates the amount to be paid to customers based on historical experience and expected rate of discount. The estimated discount amount is recorded as a deduction from net sales.

All amounts billed to a customer related to shipping and handling are classified as sales while all costs incurred by the Company for shipping and handling are classified as selling expenses. The amounts charged to selling expenses are \$1,418 thousand, \$1,332 thousand and \$1,867 thousand for the years ended December 31, 2007, 2006 and 2005, respectively.

**Derivative Financial instruments**

The Company applies the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, as amended. This Statement requires the recognition of all derivative instruments as either assets or liabilities measured at fair value.

Under the provisions of SFAS No. 133, the Company may designate a derivative instrument as hedging the exposure to variability in expected future cash flows that are attributable to a particular risk (a cash flow hedge) or hedging the exposure to changes in the fair value of an asset or a liability (a fair value hedge). Special accounting for qualifying hedges allows the effective portion of a derivative instrument's gains and losses to offset related results on the hedged item in the consolidated statements of operations and requires that a company formally document, designate and assess the effectiveness of the transactions that receive hedge accounting treatment. Both at the inception of a hedge and on an ongoing basis, a hedge must be expected to be highly effective in achieving offsetting changes in cash flows or fair value attributable to the underlying risk being hedged. If the Company determines that a derivative instrument is no longer highly effective as a hedge, it discontinues hedge accounting prospectively and future changes in the fair value of the derivative are recognized in current earnings. The Company assesses hedge effectiveness at the end of each quarter.

In accordance with SFAS No. 133, changes in the fair value of derivative instruments that are cash flows hedges are recognized in accumulated other comprehensive income (loss) and reclassified into earnings in the period in which the hedged item affects earnings. Ineffective portions of a derivative instrument's change in fair value are immediately recognized in earnings. Derivative instruments that do not qualify, or cease to qualify, as hedges must be adjusted to fair value and the adjustments are recorded through net income (loss).

**Advertising**

The Company expenses advertising costs as incurred. Advertising expense was approximately \$148 thousand, \$81 thousand and \$310 thousand for the years ended December 31, 2007, 2006 and 2005.

**Product Warranties**

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



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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

**Research and Development**

Research and development costs are expensed as incurred and include wafer, masks, employee expense, contractor fees, building costs, utilities, and administrative expenses.

**Licensed Patents and Technologies**

The Company has entered into a number of royalty agreements to license patents and technology used in the design and manufacture of its products. The payments under these agreements include an initial payment to acquire the rights, and a royalty payment, calculated based upon the sales of the related products. The initial payments, usually paid in installments, represents a non-refundable commitment, such that the total present value of these payments is recorded as a liability upon execution of the agreement, and the costs are deferred over the period of the agreement. The royalty payments are charged to the statement of operations as incurred.

**Unit-Based Compensation**

Effective January 1, 2006, the Company adopted the provisions of SFAS 123(R), *Share-Based Payment (revised 2004)*. As the Company elected to use the modified prospective application method, no restatement was made to the consolidated statements of operations for prior periods. Under SFAS 123(R), unit-based compensation cost is measured at grant date, based on the fair value of the award, and is recognized as expense over the requisite service period. As permitted under SFAS No. 123(R), the Company elected to recognize compensation expense for all options with graded vesting based on the graded attribution method.

Prior to 2006, the Company accounted for its unit-based compensation using the intrinsic value method prescribed in Accounting Principles Board ( APB ) Opinion No. 25, *Accounting for Stock Issued to Employees*, and provided the required pro forma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation*. As the exercise prices for all option grants were in excess of the fair value of the underlying units on the respective grant dates, no compensation cost was recorded for the year ended December 31, 2005.

Consistent with the valuation method for the disclosure-only provisions of FAS No. 123, the Company uses the Black-Scholes option pricing-model to measure the grant-date-fair-value of options. The Black-Scholes model requires certain assumptions to determine an option's fair value, including expected term, risk free interest, expected volatility and fair value of underlying common unit. The expected term of each option grant was based on employees' expected exercises and post-vesting employment termination behavior and the risk free interest rate was based on the U.S. Treasury yield curve for the period corresponding with the expected term at the time of grant. The expected volatility was estimated using historical volatility of share prices of similar public entities. No dividends were assumed for this calculation of option value. The Company estimates the fair value of the underlying common unit because there is no public trading market for its common units.

**Earnings per Unit**

In accordance with SFAS No. 128, *Earnings Per Share*, the Company computes basic earnings per unit by dividing net income available to common unitholders by the weighted average number of common units outstanding during the period which would include to the extent their effect is dilutive: redeemable convertible preferred units, options to purchase common units and warrants to purchase common units. Diluted earnings per unit reflect the dilution of potential common units outstanding during the period. In determining the hypothetical units repurchased, the Company uses the average unit price for the period.

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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

**Income Taxes**

MagnaChip Semiconductor LLC has elected to be treated as a partnership for U.S. federal income tax purposes, and therefore is not subject to income taxes on its income. Taxes on its income are the responsibility of the individual equity owners of MagnaChip Semiconductor LLC. The Company operates a number of subsidiaries, which are subject to local income taxes in those markets.

The Company accounts 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 upon 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.

On January 1, 2007, the Company adopted the provisions of FASB issued interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109*, which prescribes a recognition threshold and measurement attribute for tax positions taken or expected to be taken in a tax return. This interpretation also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The evaluation of a tax position in accordance with this interpretation is a two-step process. In the first step, recognition, the Company determines whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step addresses measurement of a tax position that meets the more-likely-than-not criteria. The tax position is measured at the largest amount of benefit that has a likelihood of greater than 50 percent of being realized upon ultimate settlement. Differences between tax positions taken in a tax return and amounts recognized in the financial statements will generally result in (a) an increase in a liability for income taxes payable or a reduction of an income tax refund receivable, (b) a reduction in a deferred tax asset or an increase in a deferred tax liability or (c) both (a) and (b). Tax positions that previously failed to meet the more-likely-than-not recognition threshold should be recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not recognition threshold should be de-recognized in the first subsequent financial reporting period in which that threshold is no longer met. Use of a valuation allowance as described in FAS 109 is not an appropriate substitute for the de-recognition of a tax position. The requirement to assess the need for a valuation allowance for deferred tax assets based on sufficiency of future taxable income is unchanged by this interpretation.

**Segment Information**

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

The Company's chief operating decision maker (CODM) as defined by SFAS 131, *Disclosure about Segments of an Enterprise and Related Information*, allocates resources to and assesses the performance of each segment using information about its revenue and gross profit. The Company does not identify or allocate assets

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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

by segments, nor does the CODM evaluate operating segments using discrete asset information. In addition, the Company does not allocate operating expenses, interest income or expense, other income or expense, or income tax expenses to the segments. Management does not evaluate segments based on these criteria.

Prior to 2006, the Company had a single reportable segment. In 2006, subsequent to the appointment of our new CODM, the Company changed the manner in which the CODM reviewed the Company's operational results and made significant business decisions to include disaggregated financial information of its three primary business units. Segment information for the year ended December 31, 2005 was prepared in conformity with the current segment structure.

**Concentration of Credit Risk**

The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral for customers on accounts receivable. The Company maintains reserves for potential credit losses, but historically has not experienced significant losses related to individual customers or groups of customers in any particular industry or geographic area. The Company derives a substantial portion of its revenues from export sales through its overseas subsidiaries in Asia, North America and Europe.

**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* (FAS 141R), which replaces FASB Statement No. 141. FAS 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. FAS 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 FAS 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* (FAS 160). FAS 160 states that accounting and reporting for minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. FAS 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. FAS 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 FAS 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*, which provides companies with an option to report selected financial assets and liabilities at fair value in an attempt to reduce both complexity in accounting for financial instruments and the volatility in earnings caused by measuring related assets and liabilities differently. This Statement is effective as of the beginning of an entity's first fiscal year beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption may have on its consolidated financial statements.

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

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

**3. Accounts Receivable**

Accounts receivable as of December 31, 2007 and 2006 consist of the following:

	December 31, 2007	December 31, 2006
Accounts receivable	\$ 102,151	\$ 65,203
Notes receivable	25,179	16,812
Less:		
Allowances for doubtful accounts	(1,367)	(1,418)
Cash return reserve	(914)	(1,450)
Low yield compensation reserve	(1,260)	(2,482)
Accounts receivable, net	\$ 123,789	\$ 76,665

Changes in allowance for doubtful accounts for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Beginning balance	\$ (1,418)	\$ (617)	\$ (383)
Bad debt expense	(161)	(739)	(229)
Write off	208		
Translation adjustments	4	(62)	(5)
Ending balance	\$ (1,367)	\$ (1,418)	\$ (617)

Changes in cash return reserve for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Beginning balance	\$ (1,450)	\$ (3,000)	\$ (2,156)
Addition to reserve	(2,509)	(2,100)	(8,131)
Payment made	3,040	3,862	7,351
Translation adjustments	5	(212)	(64)

Ending balance	\$ (914)	\$ (1,450)	\$ (3,000)
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**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

(Tabular dollars in thousands, except unit data)

Changes in low yield compensation reserve for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Beginning balance	\$ (2,482)	\$ (2,666)	\$ (2,911)
Addition to reserve	(1,307)	(4,117)	(4,747)
Payment made	2,523	4,520	5,059
Translation adjustments	6	(219)	(67)
Ending balance	\$ (1,260)	\$ (2,482)	\$ (2,666)

**4. Inventories**

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

	December 31, 2007	December 31, 2006
Finished goods	\$ 19,557	\$ 16,169
Semi-finished goods and work-in-process	56,877	39,492
Raw materials	7,498	11,774
Materials in-transit	555	2,063
Less: valuation allowances	(8,620)	(11,652)
Inventories, net	\$ 75,867	\$ 57,846

Changes in valuation allowances for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Beginning balance	\$ (11,652)	\$ (7,612)	\$ (6,274)
Reversal of (addition to) reserve	1,101	(10,212)	(2,816)
Write off	1,888	6,868	1,627
Translation adjustments	43	(696)	(149)
Ending balance	\$ (8,620)	\$ (11,652)	\$ (7,612)

**5. Property, Plant and Equipment**

Property, plant and equipment as of December 31, 2007 and 2006 are comprised of the following:

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	<b>December 31, 2007</b>	<b>December 31, 2006</b>
Buildings and related structures	\$ 150,951	\$ 162,383
Machinery and equipment	429,259	369,683
Vehicles and others	54,556	42,772
	634,766	574,838
Less: accumulated depreciation	(367,501)	(252,814)
Land	12,404	12,481
Construction in-progress		1,774
Property, plant and equipment, net	\$ 279,669	\$ 336,279

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

Aggregate depreciation expenses totaled \$129,871 thousand, \$153,245 thousand and \$157,678 thousand for the years ended December 31, 2007, 2006 and 2005, respectively. In addition, capitalized interest costs totaled \$0, \$64 thousand and \$144 thousand for the years ended December 31, 2007, 2006 and 2005, respectively.

Property, plant and equipment are pledged as collateral for our senior secured revolving credit facility and our Second Priority Senior Secured Notes to a maximum of \$780 million as of December 31, 2007 and 2006.

**6. Intangible assets**

Intangible assets at December 31, 2007 and 2006 are as follows:

	December 31, 2007	December 31, 2006
Technology	\$ 21,157	\$ 21,289
Customer relationships	169,300	170,209
Goodwill	14,245	15,095
Intellectual property assets	9,320	9,742
Less: accumulated amortization	(109,297)	(76,606)
Intangible assets, net	\$ 104,725	\$ 139,729

On March 6, 2005, the Company acquired ISRON Corporation for cash consideration of \$16,158 thousand. In connection with this acquisition, the Company recorded \$8,000 thousand in technology, \$5,310 thousand in customer relationships and \$14,245 thousand in goodwill, respectively.

Aggregate amortization expenses for intangible assets totaled \$33,564 thousand, \$35,315 thousand and \$45,251 thousand for the years ended December 31, 2007, 2006 and 2005, respectively. The estimated aggregate amortization expense of intangible assets for the next five years is \$27,161 thousand in 2008, \$18,324 thousand in 2009, \$16,723 thousand in 2010, \$13,964 thousand in 2011 and \$10,499 thousand in 2012.

Intangible assets are pledged as collateral for our senior secured revolving credit facility and our Second Priority Senior Secured Notes as of December 31, 2007 and 2006.

**7. Product Warranties**

Changes in accrued warranty liabilities for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Beginning balance	\$ 112	\$ 1,036	\$ 1,448
Addition to warranty reserve	586	(340)	1,362
Payments made	(486)	(647)	(1,804)
Translation adjustments	(1)	63	30



Ending balance	\$ 211	\$ 112	\$ 1,036
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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

**8. 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 one day before the termination date of such commitments. As of December 31, 2007 and 2006, the Company had borrowed \$80,000 thousand and \$0 under this credit agreement, respectively.

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

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

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

On September 28, 2007, the Company entered into the Eighth Amendment to Credit Agreement, dated as of September 28, 2007 (the Eighth Amendment ), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto, and UBS AG, Stamford Branch, as administrative agent and collateral agent. Under the Eighth Amendment, among other things, the financial covenants regarding total leverage, interest coverage, capital expenditure limitations and minimum levels of EBITDA and liquidity were modified. In addition, the monthly requirement of the obligors to provide certain financial and other reports to the lenders were modified.

On November 13, 2007, the Company entered into the Ninth Amendment and Waiver to Credit Agreement, dated as of November 13, 2007 (the Ninth Amendment ), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto, and UBS AG, Stamford Branch, as administrative agent and collateral agent. Under the Ninth Amendment, the lenders under the senior secured credit facility waived certain provisions of the credit agreement to permit us to consummate the proposed corporate reorganization and the proposed public offering, and to use the proceeds from the proposed public offering as described in the registration statement. Pursuant to the Ninth Amendment, MagnaChip Semiconductor Corporation will become a guarantor, and grant a security interest with

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

respect to the obligations, under the senior secured credit facility upon the consummation of the proposed corporate reorganization, and the credit agreement will be amended effective as of the proposed corporate reorganization to provide for such guarantee and the grant of such security interest.

Details of short-term borrowings as of December 31, 2007 are presented as below:

	<b>Maturity</b>	<b>Annual interest rate (%)</b>	<b>Amount of principal</b>
Euro dollar Revolving Loan	2008-1-22 ~2008-1-28	3 month LIBOR + 4.75	\$ 30,000
ABR Revolving Loan	2008-1-2 ~ 2008-3-31	ABR + 3.75	50,000
			\$ 80,000

**9. Long-Term Borrowings**

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

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

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

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

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

As of December 31, 2007, the Company and all of its subsidiaries except for MagnaChip Semiconductor (Shanghai) Company Limited have jointly and severally guaranteed each series of the Second Priority Senior Secured Notes on a second priority senior secured basis. As of December 31, 2007, 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.

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In addition, the Company and each of its current and future direct and indirect subsidiaries (subject to certain exceptions) will be guarantors of Second Priority Senior Secured Notes and Senior Subordinated Notes.

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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

In connection with the issuance of the notes and obtaining of the credit facility, the Company capitalized certain costs and fees, which are being amortized using the effective interest method or straight-line method over their respective terms, 2009 to 2014. Amortization costs, which were included in interest expense in the accompanying statements of operations, amounted to \$3,919 thousand, \$3,701 thousand and \$3,432 thousand for the years ended December 31, 2007, 2006 and 2005, respectively. The remaining capitalized costs as of December 31, 2007, 2006 and 2005 were \$17,917 thousand, \$21,860 thousand and \$25,113 thousand, respectively.

**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 receives a variable interest rate equal to the three-month LIBOR rate plus 3.25%. In exchange, the Company pays interest at a fixed rate of 7.34%. The Swap effectively replaces 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 qualifies 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 and is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the hedge. The Company is utilizing the hypothetical derivative method to measure the effectiveness by comparing the changes in value of the actual derivative versus the change in fair value of the hypothetical derivative. Under this methodology, the actual swap was effective when compared to the hypothetical hedge, and there was no hedge ineffectiveness for the years ended December 31, 2007, 2006 and 2005.

The fair value of the Swap was estimated applying a discounted cash flow model using expected net cash flows from the fixed interest outflows and variable interest inflows during the term of the Swap. The resulting \$992 thousand of the derivative asset and \$4,521 thousand of derivative asset were recorded as current assets as of December 31, 2007 and non-current assets as of December 31, 2006, respectively, in the accompanying consolidated financial statements. Changes in fair value of the Swap are recorded under other comprehensive income in the accompanying condensed consolidated financial statements. The Company recorded decreases in the fair value of \$3,477 thousand and \$193 thousand and an increase in the fair value of \$4,534 thousand for the years ended December 31, 2007, 2006 and 2005, respectively. The Company recognized interest income of \$4,005 thousand, interest expense of \$2,944 thousand and interest expense of \$550 thousand for the years ended December 31, 2007, 2006 and 2005, respectively, which represents the differences between fixed and variable rates.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

(Tabular dollars in thousands, except unit data)

**10. Accrued Severance Benefits**

Changes in accrued severance benefits for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Beginning balance	\$ 64,642	\$ 56,967	\$ 52,925
Provisions	18,834	11,497	16,583
Transferred from acquired company			196
Severance payments	(7,151)	(8,589)	(13,831)
Translation adjustments	(456)	4,767	1,094
	75,869	64,642	56,967
Less: Cumulative contributions to the National Pension Fund	(784)	(867)	(900)
Group severance insurance plan	(909)	(939)	(943)
	\$ 74,176	\$ 62,836	\$ 55,124

The severance benefits are funded approximately 2.23%, 2.79% and 3.24% as of December 31, 2007, 2006 and 2005, respectively, through severance insurance deposits for the payment of severance benefits, and the account is deducted from accrued severance benefits. In addition, the Company expects to pay the following future benefits to its employees upon their normal retirement ages:

	Severance benefit
2008	\$
2009	70
2010	223
2011	81
2012	159
2013 - 2017	5,144

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.

**11. Redeemable Convertible Preferred Unit**

The Company issued 49,727 units as Series A redeemable convertible preferred unit (the Series A ) and 447,420 units as Series B redeemable convertible preferred unit (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. Each Series A and Series B unit has a stated value of \$1,000 per unit. As the Series A and B units are redeemable at the option of the holders, the Company classified the Series A and B units outside of permanent equity. All of Series A were redeemed by cash on December 27, 2004 and parts of Series B were redeemed by cash on December 15, 2004 and December 27, 2004.



**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

(Tabular dollars in thousands, except unit data)

Changes in Series B for the years ended December 31, 2007, 2006 and 2005 are as follows:

	Years ended December 31,					
	2007		2006		2005	
	Units	Amount	Units	Amount	Units	Amount
Series B						
Beginning of year	93,997	\$ 117,374	93,997	\$ 106,462	93,997	\$ 96,534
Accrual of preferred dividends		12,031		10,912		9,928
End of year	93,997	\$ 129,405	93,997	\$ 117,374	93,997	\$ 106,462

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.

**Conversion**

The outstanding Series B units are convertible, in whole or in part, into common equity interests upon or concurrently with the first public offering of the common equity interests of the Company at the Company's option or the holder's option based on a formula, represented by the conversion ratio. The conversion ratio for the Series B units is an amount equal to the original issue price per unit plus an amount per unit equal to full cumulative dividends accrued and unpaid to the date of the consummation of the first public offering, divided by the per common equity interest price to the public in the Company's first public offering of equity securities.

**Dividends**

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. Such dividends are payable in semi-annual installments in arrears commencing March 15, 2005.

**Liquidation**

In the event of liquidation, the holders of Series B are entitled to receive after all creditors of the Company have been paid in full but before any amounts are paid to the holders of any units ranking junior to the Series B with respect to dividends or upon liquidation (including the common units), out of the assets of the Company legally available for distribution to its members, whether from capital, surplus or earnings, an amount equal to the Series B original issue price in cash per unit plus an amount equal to full cumulative dividends accrued and unpaid thereon to the date of final distribution, and no more. If the net assets of the Company are insufficient to pay the holders of all outstanding Series B and of any units ranking on a parity with the Series B, the full amounts to which they respectively shall be entitled, such assets, or the proceeds thereof, shall be distributed ratably among the holders of the Series B and any units ranking on a parity with the Series B in accordance with the amounts which would be payable on such distribution if the amount to which the holders of the Series B and any units ranking on a parity with the Series B are entitled were paid in full.

**Voting**

As provided in Company Operating Agreement, the holders of Series B shall not be entitled to vote on any matter submitted to a vote of the Members, and not be entitled to notice of any meeting of Members.





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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

***Redemption***

If any outstanding Series B remain outstanding on the 14<sup>th</sup> anniversary after issuance of the Series B, then the holders of a majority of the then outstanding Series B shall have the right to elect to have the Company redeem all outstanding Series B from funds legally available, at a price per unit equal to \$1,000 plus an amount per unit equal to full cumulative dividends accrued and unpaid thereon to the redemption date.

Also the Series B may be redeemed from funds legally available, in whole or in part, at the election of the Company, expressed by resolution of the board of directors, at any time and from time to time at a price of \$1,000 per unit plus any cumulative dividends accrued and unpaid.

**12. Warrant**

In connection with the Original Acquisition, the Company issued a warrant, which is recorded as additional paid in capital, to Hynix, which enables Hynix to purchase 5,079,254 common units of the Company. The value of each warrant to purchase one common unit is \$0.414, which was estimated using the Black-Scholes option pricing model using the following assumptions: fair value of \$1.00 per unit; exercise price of \$1.00 per unit; risk free rate of interest of 2.50%; volatility of 86%; dividend rate of 0%; and term of 2 years. This warrant expired unexercised in accordance with its terms on October 6, 2006.

**13. Equity Incentive Plans**

The Company adopted two equity incentive plans effective October 6, 2004 and March 21, 2005, respectively, which are administered by the Compensation Committee designated by the board of directors. Employees, consultants and non-employee directors are eligible for the grant of options to purchase the Company's common units or restricted common units subject to terms and conditions determined by the Committee. The term of options in no event exceed ten years from the date of grant. As of December 31, 2007, an aggregate maximum of 7,890,864 common units were authorized and reserved for all future and outstanding grants of options.

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

Upon the termination of a unit option grantee's employment prior to a public offering, the Company shall have the right to repurchase all or any of the common units acquired by the grantee upon exercise of any of his or her options for a cash payment equal to the fair market value of such common units on the date of repurchase. The Company's repurchase right shall terminate ninety days after the termination date.

During the three months ended December 31, 2004, restricted units were issued upon the exercise of certain options to purchase restricted common units at the exercise price of \$1 per unit. Restricted units issued are subject to restrictions which generally lapse in installments over a four-year period. Under the terms and conditions of these restricted common units, the restricted units are subject to forfeiture upon the termination of the restricted unitholder's employment with the Company. Upon termination, the Company may repurchase all, or any portion of the restricted common units for either \$1.00 per unit (the exercise price) or the fair market value

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

of the restricted common units at the time of repurchase. If the termination is for Cause, as defined in the Service Agreements entered into with each restricted unitholder, the repurchase price per unit will be \$1. However, if the termination is for any other reason, then the Company may repurchase all or any portion of the restricted common units for which the restricted period has not lapsed as of the date of termination for a repurchase price per unit of \$1, and may repurchase all or any portion of the restricted common units for which the restricted period has lapsed as of the date of termination for a repurchase price per unit equal to fair market value. Termination for Cause is defined in the Service Agreements to mean a termination of the restricted unitholder's employment with the Company because of (a) a failure by the restricted unitholder to substantially perform the restricted unitholder's customary duties with the Company in the ordinary course (other than in certain specified circumstances); (b) the restricted unitholder's gross negligence, intentional misconduct or fraud in the performance of his or her employment; (c) the restricted unitholder's indictment for a felony or to a crime involving fraud or dishonesty; (d) a judicial determination that the restricted unitholder committed fraud or dishonesty against any person or entity; or (e) the restricted unitholder's material violation of one or more of the Company's policies applicable to the restricted unitholder's employment as may be in effect from time to time. Prior to the adoption of SFAS 123(R), the Company accounted for its unit awards under Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*. Using the intrinsic value method prescribed by APB 25, the Company did not record any compensation expense because the fair market value of the common unit underlying the options was below the exercise price of the options on the date of grant. Upon the adoption of FAS 123(R), the compensation costs relating to the unvested units are expensed over the remaining requisite service period.

The following summarizes unit option and restricted unit activities for the years ended December 31, 2007 and 2006. At the date of grant, all options had an exercise price at or above the fair value of common units:

	Number of restricted units	Number of options	Weighted average exercise price of unit options (in US dollars)	Aggregate intrinsic value of unit options	Weighted average remaining contractual life of unit options
Outstanding at January 1, 2006	1,726,062	3,780,643	1.6		
Granted		2,107,500	1.6		
Exercised		46,063	1.9		
Forfeited / Repurchased	409,348	772,552	1.5		
Released from restriction	694,747		N/A		
Outstanding at December 31, 2006	621,967	5,069,528	1.6	35	8.6 years
Vested and expected to vest at December 31, 2006	N/A	4,388,110	1.6	31	8.5 years
Exercisable at December 31, 2006	N/A	1,588,000	1.6	19	7.9 years
Outstanding at January 1, 2007	621,967	5,069,528	1.6		
Granted		710,000	3.5		
Exercised		124,938	1.2	19	
Forfeited / Repurchased		737,750	1.8		
Released from restriction	353,624		N/A		
Outstanding at December 31, 2007	268,343	4,916,840	1.9	11,019	7.9 years
Vested and expected to vest at December 31, 2007	N/A	4,444,627	1.8	10,114	7.8 years

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Exercisable at December 31, 2007	N/A	2,541,944	1.6	6,318	7.3 years
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**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Consolidated Financial Statements (Continued)****(Tabular dollars in thousands, except unit data)**

Total compensation expense recorded for the restricted units and unit options pursuant to SFAS No. 123(R) for the years ended December 31, 2007 and 2006 were \$604 thousand and \$243 thousand, respectively. As of December 31, 2007 and 2006, there were \$457 thousand and \$701 thousand, respectively, of total unrecognized compensation cost related to unvested restricted units and unit options, which are expected to be recognized over a weighted average future period of 1.2 years and 1.2 years, respectively. Total fair value of restricted units released from restriction for the years ended December 31, 2007 and 2006 are \$164 thousand and \$459 thousand, respectively. Total fair value of options vested for the years ended December 31, 2007 and 2006 are \$316 thousand and \$167 thousand, respectively.

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

	Years ended December 31,		
	2007	2006	2005
Grant-date fair value of option (in US dollars)	\$ 0.67	\$ 0.22	\$ 0.22
Expected term	2.1 Years	2.3 Years	2.1 Years
Risk-free interest rate	4.4%	4.9%	3.3%
Expected volatility	46.6%	46.7%	57.8%
Expected dividends			

The total cash received from employees as a result of option exercises was \$151 thousand, \$88 thousand and \$112 thousand for the years ended December 31, 2007, 2006 and 2005, respectively.

The following presents pro forma net loss and per unit data as if the fair value based method had been applied to account for the unit-based compensation for the year ended December 31, 2005:

	Year ended December 31, 2005
Net income (loss), as reported	\$ (100,898)
Dividends accrued on preferred units	9,928
Net income (loss) attributable to common units	(110,826)
Add: unit-based compensation expense included in reported net income (loss), net of tax	
Deduct: unit-based compensation expense determined under the fair value method, net of tax	(411)
Pro forma net income (loss)	\$ (111,237)
As reported income (loss) per unit	\$ (2.10)
Pro forma income (loss) per unit	\$ (2.10)

**14. Restructuring and Impairment Charges****2007 Restructuring and Impairment Charges**

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During the year ended December 31, 2007, the Company recorded restructuring and impairment charges totaling \$12,084 thousand, which included \$10,106 thousand of impairment charges under SFAS No. 144, *Accounting for the Impairment or Disposal of Long Lived Assets* ( SFAS No. 144 ), and \$1,978 thousand of restructuring charges and SFAS 146, *Accounting for Cost Associated with Exit of Disposal Activities* ( SFAS No. 146 ). The Impairment charges and restructuring charges were recorded related to the closure of one of the

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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

Company's five-inch wafer fabrication facilities (the asset group) that has 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.

The restructuring charges were related to the decision to close the Company's five-inch wafer fabrication facility.

***2006 Restructuring and Impairment Charges***

During the year ended December 31, 2006, the Company recorded restructuring and impairment charges totaling \$94,266 thousand, which included \$92,858 thousand of impairment charges under SFAS 144 and \$1,408 thousand of restructuring charges under SFAS 146.

The impairment charges of \$92,540 thousand recorded during 2006 related to certain fixed assets and technology and customer-based intangible asset (the asset group) comprising our Imaging Solution business. At the end of fiscal year 2005, the capacity utilization of the fabrication facility was under the level that we believe to be normal. This was primarily due to a transition in product mix coupled with a seasonal decrease in market demand, which was deemed to be temporary and recoverable. However, in 2006, our management determined, based on revised forecasting, that the projected demand for certain of its products was significantly less than previously forecasted and that this decline was not temporary or seasonal. Therefore, we assessed whether there had been a material impairment on the asset group pursuant to SFAS 144 and, based on the assessment, recorded impairment charges.

The impairment charge was measured as the 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. The net book value of the asset group before the impairment charges was approximately \$185,985 thousand.

In addition, the Company recorded an impairment charges in the amount of \$318 thousand related to the disposition of certain assets previously designated as assets held-for-sale and \$1,408 thousand of restructuring charges in connection with the termination of certain of our management and employees.

***2005 Restructuring and Impairment Charges***

During the year ended December 31, 2005, the Company recorded \$36,234 thousand of restructuring and impairment charges which included \$33,576 thousand of asset impairments and \$2,658 thousand of restructuring.

In an effort to focus on its major business segments Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services, the Company made a strategic decision to divest its Application

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

Processor business. Based on this decision, the Company recognized impairment charges on certain tangible and intangible assets related to the divestiture. The impairment charge was measured as the excess of the carrying value of the asset group over the fair value measured at the selling price of the assets.

In addition, the Company took a total of \$2,658 thousand of restructuring charges which included early retirement costs and other related costs associated with the sale of Application Processor business.

**15. Income Tax Expenses**

The Company's income tax expenses are composed of domestic and foreign income taxes depending on the relevant tax jurisdiction. Domestic refers to the income before taxes, current income taxes and deferred income taxes generated or incurred in the United States, where the ultimate parent of the Company resides.

The components of income tax expense are as follows:

	Years ended December 31,		
	2007	2006	2005
Income before income taxes			
Domestic	\$ 1,184	\$ 5,862	\$ (3,528)
Foreign	(172,595)	(225,914)	(95,554)
	\$ (171,411)	\$ (220,052)	\$ (99,082)
Current income taxes expense (benefits)			
Domestic	\$ 533	\$ (17)	\$ (9)
Foreign	8,104	7,226	14,041
FIN 48 liability (foreign)	163		
	8,800	7,209	14,032
Deferred income taxes expense (benefits)			
Domestic			
Foreign	339	2,049	(12,216)
	339	2,049	(12,216)
Total income tax expenses	\$ 9,139	\$ 9,258	\$ 1,816

The ultimate parent of the Company is a limited liability company, a non-taxable entity for US tax purposes and thus the statutory income tax rate is expected to be zero. A substantial portion of the income tax expenses above is incurred from MagnaChip Korea, which is the principal operating entity within the Company. The statutory income tax rate of MagnaChip Korea, including tax surcharges, applicable to the Company was approximately 27.5% in 2007 and 2006. MagnaChip Korea is eligible for tax exemption where its corporate income tax is reduced by 50% from 2004 to 2006 and 30% from 2007 to 2008.





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

The provision for domestic and foreign income taxes incurred is different from the amount calculated by applying the statutory tax rate to the net income before income taxes. The significant items causing this difference are as follows:

	Year ended December 31,		
	2007	2006	2005
Provision computed at statutory rate	\$	\$	\$
Permanent differences	5,134	1,850	(521)
Change in statutory tax rate	(18,242)	13,035	1,256
Adjustment for overseas tax rate	(44,929)	(58,493)	(27,745)
Change in valuation allowance	67,013	52,866	28,826
FIN 48 liability	163		
<b>Total statutory income taxes</b>	<b>\$ 9,139</b>	<b>\$ 9,258</b>	<b>\$ 1,816</b>

A summary of the composition of net deferred income tax assets (liabilities) at December 31, 2007 and 2006 are as follows:

	December 31, 2007	December 31, 2006
<b>Deferred tax assets</b>		
Inventories	\$ 3,679	\$ 7,587
Accrued expenses	1,833	1,030
Product warranties	248	321
Other reserves	399	575
Severance benefits	13,040	7,802
Property, plant and equipments	28,413	34,712
NOL carry-forwards	114,408	46,537
Tax credit	18,564	15,752
Royalty income	9,500	10,163
Others	699	815
Total deferred tax assets	190,783	125,294
Less: valuation allowance	(165,977)	(100,016)
	24,806	25,278
<b>Deferred tax liabilities</b>		
Foreign currency gain	438	
Debt issuance cost	95	63
Intangible assets	14,445	15,048
Total deferred tax liabilities	14,978	15,111
Net deferred tax assets	\$ 9,828	\$ 10,167



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

Changes in valuation allowance for deferred tax assets for the years ended December 31, 2007 and 2006 are as follows:

	December 31, 2007	December 31, 2006
Beginning balance	\$ 100,016	\$ 42,695
Charge to expenses	67,013	52,866
Translation adjustment	(1,052)	4,455
Ending balance	\$ 165,977	\$ 100,016

Deferred income tax assets are recognized only to the extent that realization of the related tax benefit is more likely than not. Realization of the future tax benefits related to the deferred tax assets is dependent on many factors, including the Company's ability to generate taxable income within the period during which the temporary differences reverse, the outlook for the economic environment in which the Company operates, and the overall future industry outlook. Based on the Company's historical accounting and tax losses, management determined that it was more likely than not, that the Company would realize benefits related to its deferred tax assets in the amount of \$9,828 thousand as of December 31, 2007 and \$10,167 thousand as of December 31, 2006. Accordingly, the Company recorded a valuation allowance of \$165,977 thousand and \$100,016 thousand on its net deferred tax assets for 2007 and 2006, respectively.

At December 31, 2007, the Company had approximately \$421,349 thousand of net operating loss carry-forwards available to offset future taxable income, which expires in varying amounts starting from 2011 to 2025. The majority of net operating loss is related to MagnaChip Korea. The Company also has Korean and Dutch tax credit carry-forwards of approximately \$10,357 thousand and \$8,207 thousand, respectively. The Korean tax credits expire at various dates starting from 2011 to 2013, and the Dutch credits are carried forward to be used for an indefinite period of time.

**Uncertainty in Income Taxes**

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

The Company adopted the provisions of 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 \$1,554 thousand of liabilities for unrecognized tax benefits, 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 December 31, 2007, the Company recorded \$1,724 thousand of liabilities for unrecognized tax benefits.

The Company recognizes interest and penalties accrued related to unrecognized tax benefits as income tax expenses. The Company recognized \$163 thousand of interest and penalties as income tax expense for the year ended December 31, 2007. Total interest and penalties accrued as of December 31, 2007 and as of the FIN No. 48 adoption date were \$694 thousand and \$530 thousand, respectively.

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Notes to Consolidated Financial Statements (Continued)**

(Tabular dollars in thousands, except unit data)

A tabular reconciliation of the total amounts of unrecognized tax benefits at the beginning and end of the year ended December 31, 2007 is as follows:

	Year ended December 31, 2007
Unrecognized tax benefits, balance at January 1, 2007	\$ 2,299
Additions based on tax positions related to the current year	
Additions for tax positions of prior years	475
Reductions for tax positions of prior years	(1,197)
Settlements	
Lapse of statute of limitations	
Translation adjustment	16
Unrecognized tax benefits, balance at December 31, 2007	\$ 1,593

**16. Geographic and Segment Information**

The following sets forth information relating to the reportable segments:

	Years ended December 31,		
	2007	2006	2005
<b>Net Sales</b>			
Display Solutions	\$ 331,684	\$ 273,656	\$ 326,027
Imaging Solutions	82,848	60,479	163,326
Semiconductor Manufacturing Services	321,034	342,416	345,437
All other	56,790	67,802	102,866
Total segment net sales	\$ 792,356	\$ 744,353	\$ 937,656
<b>Gross Profit</b>			
Display Solutions	\$ 41,524	\$ 35,603	\$ 66,534
Imaging Solutions	6,918	(4,008)	25,423
Semiconductor Manufacturing Services	67,127	45,712	110,389
All other	22,000	22,134	6,311
Total segment gross profit	\$ 137,569	\$ 99,441	\$ 208,657

The following is a summary of net sales by region, based on the location of the customer:

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	Years ended December 31,		
	2007	2006	2005
Korea	\$ 447,059	\$ 413,670	\$ 512,366
Asia Pacific	193,787	172,981	251,173
Japan	72,845	78,321	97,841
North America	58,506	62,357	56,907
Europe	20,159	17,024	19,369
	\$ 792,356	\$ 744,353	\$ 937,656

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

Over 99% of the Company's property, plant and equipment are located in Korea as of December 31, 2007.

Net sales from the Company's top ten largest customers accounted for 59%, 66% and 63%, for the years ended December 31, 2007, 2006 and 2005, respectively.

The Company recorded \$182.6 million, \$193.1 million and \$216.5 million of sales to one customer within its Display Solutions segment, which represents greater than 10% of net sales, for the years ended December 31, 2007, 2006 and 2005, respectively.

**17. Commitments and Contingencies*****Operating Agreements with Hynix***

In connection with the Original Acquisition, the Company entered into several definitive agreements with Hynix regarding key materials, campus facilities, research and development equipment and information technology, factory automation, wafer foundry services, and a non-exclusive cross license that provides the Company with access to certain of Hynix's intellectual property for use in the manufacture and sale of non-memory semiconductor products. The Company also agreed to provide certain utilities and infrastructure support services to Hynix. The obligation to provide services under these agreements generally lasts for one to five years from the date of the Original Acquisition. The obligation to provide certain services lasts indefinitely.

Upon the closing of the Original Acquisition, MagnaChip Korea and Hynix also entered into lease agreements under which MagnaChip Korea leases from Hynix (i) certain exclusive-use space plus common- and joint-use space in several buildings, primarily warehouses and utility facilities, in Cheongju, Korea. These leases are generally for an initial term of 20 years plus an indefinite number of renewal terms of 10 years each. Each of the leases is cancelable upon 90 days' notice by the lessee. The Company also leased from Hynix certain exclusive-use plus common- and joint-use land located in Cheongju, Korea. The term of this agreement is indefinite unless otherwise agreed between the both parties, and as long as the buildings remain on the lease site and are owned and used by the Company for permitted uses.

***Operating Leases***

The Company leases land, office building and equipment under various operating lease agreements that expire through 2034. Rental expenses were approximately \$11,614 thousand, \$12,008 thousand and \$13,913 thousand for the years ended December 31, 2007, 2006 and 2005, respectively.

As of December 31, 2007, the minimum aggregate rental payments due under non-cancelable lease contracts are as follows:

2008	\$ 11,237
2009	11,245
2010	11,246
2011	11,248
2012	11,249
	\$ 56,225





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**MagnaChip Semiconductor LLC and Subsidiaries**

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

**(Tabular dollars in thousands, except unit data)**

***Advisory Agreements***

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 is 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, 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, the Company accrued \$3,545 thousand of accrued expenses under these agreements, which is included in selling, general and administrative expenses in the accompanying consolidated financial statements. 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 the First Amendment to Advisory Agreement pursuant to which, upon 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.

***Undrawn line of credit***

The undrawn portion of the new senior secured credit line was \$4,531 thousand, \$93,792 thousand and \$82,956 thousand as of December 31, 2007, 2006 and 2005, respectively.

***Payments of Guarantee***

As of December 31, 2007 and 2006, the Company has provided guarantees for bank loans that employees borrowed to participate in the issuance of new shares of Hynix in 1999. The outstanding balances of guarantees for payments provided by the Company amounted to approximately \$228 thousand and \$248 thousand as of December 31, 2007 and 2006, respectively.

***IPO Incentives***

The Company has committed to its employees that it will pay an IPO incentive to all employees, other than senior vice presidents and above, who are employed by the Company at the closing date of the Company's initial public offering. The incentive is estimated to be \$30 million.

**18. Related Party Transactions**

Funds related to Court Square, Francisco Partners and CVC Capital own 34.0%, 34.0% and 18.3%, respectively, of the common units, and 35.9%, 35.9% and 19.3%, respectively, of the Series B units outstanding at December 31, 2007.

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

Transactions between the Company and its related parties for each year are as follows:

	Years ended December 31,		
	2007	2006	2005
Advisory Fee			
Court Square	\$	\$	\$ 1,397
Francisco Partners			1,397
CVC Capital			751
<b>Total</b>	<b>\$</b>	<b>\$</b>	<b>\$ 3,545</b>

Loans to employees as of December 31, 2007 and 2006 are as follows:

	December 31, 2007	December 31, 2006
Short-term loans	\$ 37	\$ 54
Long-term loans	386	434
<b>Total</b>	<b>\$ 423</b>	<b>\$ 488</b>

In November 2006, the Company's Chief Executive Officer and Chairman, purchased in the open market \$69 thousand aggregate principal amount of the Company's 8% senior subordinated notes due 2014, and the Company's President and Chief Financial Officer and a director, purchased in the open market \$138 thousand aggregate principal amount of the 8% notes. Additionally, Paul C. Schorr IV, a director, purchased \$175 thousand in aggregate principal amount of the 8% notes in the open market in February 2007 and an additional \$280 thousand in aggregate principal amount of the 8% notes in August 2007.

**19. Earnings per Unit**

The following table illustrates the computation of basic and diluted loss per common unit:

	Years ended December 31,		
	2007	2006	2005
Net income (loss)	\$ (180,550)	\$ (229,310)	\$ (100,898)
Dividends to preferred unitholders	(12,031)	(10,912)	(9,928)
<b>Net income (loss) attributable to common units</b>	<b>\$ (192,581)</b>	<b>\$ (240,222)</b>	<b>\$ (110,826)</b>
Weighted-average common units outstanding	52,297,192	52,911,734	52,898,497
<b>Basic and diluted income (loss) per unit</b>	<b>\$ (3.68)</b>	<b>\$ (4.54)</b>	<b>\$ (2.10)</b>



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

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

	December 31, 2007	December 31, 2006	December 31, 2005
Redeemable convertible preferred units	93,997	93,997	93,997
Options	4,916,840	5,069,528	3,780,643
Warrants			5,079,254

**20. 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 December 31, 2007 and 2006, condensed consolidating statements of operations and of cash flows for the years ended December 31, 2007, 2006 and 2005 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 Consolidated Financial Statements (Continued)**

(Tabular dollars in thousands, except unit data)

**Condensed Consolidating Statement of Operations**

For the year ended December 31, 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	\$	\$	\$ 772,682	\$ 355,669	\$ (335,995)	\$ 792,356
Cost of sales			652,265	312,085	(309,563)	654,787
Gross profit			120,417	43,584	(26,432)	137,569
Selling, general and administrative expenses	323	1,299	77,650	13,932	(214)	92,990
Research and development expenses			139,941	24,350	(25,428)	138,863
Restructuring and impairment charge			12,084			12,084
Operating income (loss)	(323)	(1,299)	(109,258)	5,302	(790)	(106,368)
Other income (expenses)	1	8,708	(57,619)	(16,133)		(65,043)
Income (loss) before income taxes, equity in loss of related equity investment	(322)	7,409	(166,877)	(10,831)		