

MAGNACHIP SEMICONDUCTOR LLC
Form 10-Q
May 16, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

or

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

Commission file number 333-126019-09

MAGNACHIP SEMICONDUCTOR LLC

(Exact name of Registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

c/o MagnaChip Semiconductor S.A.

Not Applicable

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

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Luxembourg, Grand Duchy of Luxembourg

(Address of principal executive offices)

(Zip Code)

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

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

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

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MagnaChip Semiconductor LLC and Subsidiaries

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

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

The accompanying notes are an integral part of these financial statements

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

	April 1, 2007	December 31, 2006
Assets		
Current assets		
Cash and cash equivalents	\$ 59,264	\$ 89,173
Accounts receivable, net	80,717	76,665
Inventories, net	69,362	57,846
Other receivables	6,707	6,754
Other current assets	13,914	13,626
Total current assets	229,964	244,064
Property, plant and equipment, net	304,523	336,279
Intangible assets, net	130,458	139,729
Other non-current assets	47,468	49,981
Total assets	\$ 712,413	\$ 770,053
Liabilities and Unitholders Equity		
Current liabilities		
Accounts payable	\$ 64,181	\$ 62,399
Other accounts payable	26,688	32,423
Accrued expenses	34,807	23,647
Other current liabilities	3,046	2,980
Total current liabilities	128,722	121,449
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	63,381	62,836
Other non-current liabilities	5,051	2,935
Total liabilities	947,154	937,220
Commitments and contingencies		
Series A redeemable convertible preferred units; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at April 1, 2007 and December 31, 2006		
Series B redeemable convertible preferred units; 550,000 units authorized, 450,692 units issued and 93,997 units outstanding at April 1, 2007 and December 31, 2006	120,244	117,374
Total redeemable convertible preferred units	120,244	117,374
Unitholders equity		
Common units; 65,000,000 units authorized, 52,720,784 units issued and outstanding at April 1, 2007 and December 31, 2006	52,721	52,721
Additional paid-in capital	2,476	2,451
Accumulated deficit	(441,720)	(370,314)
Accumulated other comprehensive income	31,538	30,601

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Total unitholders' equity	(354,985)	(284,541)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ 712,413	\$ 770,053

The accompanying notes are an integral part of these financial statements

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

(In thousands of US dollars, except unit data)

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

The accompanying notes are an integral part of these financial statements

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

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

The accompanying notes are an integral part of these financial statements

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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

1. Significant Accounting Policies

Basis of Presentation

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

Recent accounting pronouncements

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

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

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

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

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

3. Property, Plant and Equipment

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

	April 1, 2007	December 31, 2006
Buildings and related structures	\$ 160,467	\$ 162,383
Machinery and equipment	370,015	369,683
Vehicles and others	47,082	42,772
	577,564	574,838
Less: accumulated depreciation	(285,375)	(252,814)
Land	12,334	12,481
Construction in-progress		1,774
Property, plant and equipment, net	\$ 304,523	\$ 336,279

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

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

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

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

5. Product Warranties

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

Changes in accrued warranty liabilities are as follows:

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

Table of Contents**MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****6. Long-term Borrowings**

On December 23, 2004, two of the Company's subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company issued \$500 million aggregate principal amount of Second Priority Senior Secured Notes consisting of \$300 million aggregate principal amount of Floating Rate Second Priority Senior Secured Notes and \$200 million aggregate principal amount of 6⁷/₈% Second Priority Senior Secured Notes. At the same time, such subsidiaries issued \$250 million aggregate principal amount of 8% Senior Subordinated Notes.

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

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

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

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

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

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

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

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

Interest Rate Swap

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

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

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

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

7. Accrued Severance Benefits

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

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

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

The severance benefits are funded approximately 2.64% and 3.09% as of April 1, 2007 and April 2, 2006, respectively, through the Company's National Pension Fund and group severance insurance plan which will be used exclusively for payment of severance benefits to eligible employees. These amounts have been deducted from the accrued severance benefit balance.

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

	Severance benefit
2008	\$
2009	69
2010	213

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2011	75
2012	147
2013 2017	5,087

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

Table of Contents**MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****8. Redeemable Convertible Preferred Units**

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

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

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

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

9. Earnings per Unit

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

11. Uncertainty in Income Taxes

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

The Company adopted the provisions of FIN No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of SFAS No. 109, on January 1, 2007. As a result of the implementation of FIN No. 48, the Company recognized a \$ 1,554 thousand increase in the liability for unrecognized tax benefits, which was accounted for as a reduction to the January 1, 2007, balance of retained earnings. Total amount of unrecognized tax benefits as of the date of adoption was \$6,773 thousand and it related to temporary timing differences. There was no change in total amount of unrecognized tax benefits during the three months ended April 1, 2007.

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

Table of Contents**MagnaChip Semiconductor LLC and Subsidiaries****Notes to Condensed Consolidated Financial Statements (Continued)****(Unaudited; tabular dollars in thousands, except unit data)****12. Segment Information**

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

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

The following sets forth information relating to the reportable segments:

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

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

13. Condensed Consolidating Financial Statements

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

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

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

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

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

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

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

	MagnaChip Semiconductor LLC					
	(Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Assets						
Current assets						
Cash and cash equivalents	\$ 319	\$ 1,734	\$ 45,434	\$ 11,777	\$	\$ 59,264
Accounts receivable, net			93,454	42,169	(54,906)	80,717
Inventories, net			67,363	2,020	(21)	69,362
Other receivables		718	5,708	26,440	(26,159)	6,707
Other current assets	41	20,487	14,306	10,424	(31,344)	13,914
Total current assets	360	22,939	226,265	92,830	(112,430)	229,964
Property, plant and equipment, net						
Intangible assets, net			302,669	1,854		304,523
Investments in subsidiaries	(235,064)	(311,255)	108,853	21,793	(188)	130,458
Long-term inter-company loans		793,927		634,149	(1,428,076)	
Other non-current assets		19,709	39,857	10,139	(22,237)	47,468
Total assets	(234,704)	525,320	677,644	620,058	(875,905)	712,413