

MAGNACHIP SEMICONDUCTOR LLC

Form 10-K

March 30, 2007

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

Washington, D.C. 20549

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**FORM 10-K**

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(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, 2006

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

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**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.

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

Luxembourg, Grand Duchy of Luxembourg

**83-0406195**  
(I.R.S. Employer

Identification No.)

Not Applicable

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(Address of principal executive offices)

(Zip Code)

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

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

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

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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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

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 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.**

As of March 1, 2007, the registrant had 52,720,784.047 of the registrant's common units outstanding.

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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**

**2006 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, DisplaySearch, and other third-party sources. Market data attributed to iSuppli are from CCD and CMOS Image Sensors: Handset Market Driving the Industry, Consumer Platforms Topical Report Q4 2006 dated October 2005, Pure Play Foundry Market Tracker H2 2006, and Much Room for Growth Before Display Driver Market Matures: Display Driver ICs Market Tracker Q4 2006. Market data attributed to DisplaySearch are from Quarterly Global TV Shipment & Forecast Data Tables Q4 2006, Quarterly Desktop MNT Shipment & Forecast Data Tables Q4 2006, and Quarterly NBPC Shipment & Forecast Data Table Q4 2006. Although we believe that this information is reliable, we cannot guarantee the accuracy and completeness of the information and have not independently verified it. As a result, you should be aware that market and other similar data set forth herein, and estimates and beliefs based on such data, may not be reliable. We do not have any obligation to announce or otherwise make publicly available updates or revisions to these forecasts. 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. We cannot assure you that any of these assumptions are accurate or that our assumptions correctly reflect our position in our industry.

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This report includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent expectations or beliefs of ours concerning future events, and no assurance can be given that the results described in this report will be achieved. These forward-looking statements can generally be identified by the use of statements that include words such as estimate, project, believe, expect, anticipate, intend, plan, likely, may, will, should or other similar words or phrases. All forward-looking statements are based upon information available to us on the date of this report.

These forward-looking statements are subject to risks, uncertainties and other factors, many of which are outside of our control, that could cause actual results to differ materially from the results discussed in the forward-looking statements, including, among other things, the matters discussed in this report in the sections captioned: Business, Risk factors and Management's discussion and analysis of financial condition and results of operations. There may be other factors that could cause our actual results to differ materially from the results referred to in the forward-looking statements. All forward-looking statements attributable to us or persons acting on our behalf apply only as of the date of this report and are expressly qualified in their entirety by the cautionary statements included in this report. We undertake no obligation to publicly update or revise forward-looking statements to reflect events or circumstances after the date made or to reflect the occurrence of unanticipated events. Readers are urged to carefully review and consider the various disclosures made in this report which attempt to advise interested parties of the risks and factors that may affect our business, financial condition, results of operations and prospects.

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MagnaChip and IC Media are our trademarks and trade names. All other trademarks, trade names, and service marks appearing in this report are the property of their respective owners.

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**Item 1. Business.**

**BUSINESS**

**Overview**

MagnaChip Semiconductor LLC ( MagnaChip or the Company ) is a leading designer, developer and manufacturer of mixed-signal and digital multimedia semiconductors addressing the convergence of consumer electronics and communications devices. We focus on Complementary Metal-Oxide Semiconductor ( CMOS ) image sensors and flat panel display drivers, which are complex, high-performance mixed-signal semiconductors that capture and display images and enable and enhance the features and capabilities of both small and large flat panel displays. Our solutions are used in a wide variety of consumer and commercial mass market applications, such as mobile handsets, including camera-equipped mobile handsets, flat panel monitors and televisions, consumer home and mobile displays, portable and desktop computer displays, handheld gaming devices, PDAs and audio-visual equipment such as DVD players. We serve consumer markets that we believe will have higher growth rates than those of the overall semiconductor industry.

We manufacture our products using our proprietary process technology, which we believe provides our products with cost advantages over those of our competitors. We have approximately 8,500 registered and pending patents. We believe that our proprietary in-house CMOS image sensor technology allows us to tailor our process to create brighter, sharper, more colorful picture quality in image-capture applications such as camera-equipped mobile handsets. Our flat panel display drivers enable our customers to deliver higher image quality, thinner and more power-efficient small panel displays for use in mobile handsets, handheld gaming devices and PDAs and large panel displays for use in portable and desktop computer monitors and digital televisions. We are also a leading provider of wafer foundry services whereby we leverage our specialized process technologies and low cost manufacturing facilities to produce semiconductors for third parties using their product designs.

We own and operate five wafer fabrication facilities, or fabs, which have a combined production capacity of over 119,000 eight-inch equivalent wafers per month. Our fabs provide us with large-scale, cost-effective and flexible capacity, enabling us to rapidly scale to high volume to meet shifts in demand by our end customers. Our fabs also provide us with the ability to further develop our differentiated process technologies for our own product development and manufacturing. The location of our manufacturing sites in Korea and research and development resources in Korea, Japan, and the United States provide close geographical proximity to many of our largest customers and to the core of the worldwide consumer electronics supply chain.

We sell our solutions to leading original equipment manufacturers, or OEMs, which include major branded customers as well as contract manufacturers. Our CMOS image sensors are currently designed into products offered by leading global mobile handset manufacturers. Our flat panel display drivers are currently incorporated into products offered by top flat panel display manufacturers. During the year ended December 31, 2006, we sold over 2,200 products to more than 240 customers.

In the three-month period ended December 31, 2004, and the fiscal years ended December 31, 2005, and December 31, 2006, we derived respectively 23.9%, 17.4%, and 8.1% of our consolidated revenue from CMOS image sensors, 24.8%, 34.8%, and 36.8% from flat panel display drivers, and 36.2%, 36.8%, and 46.0% from semiconductor manufacturing services.

**The Original Acquisition**

Our business was named MagnaChip Semiconductor when it was acquired from Hynix Semiconductor Inc. on October 6, 2004, by Citigroup Venture Capital Equity Partners, L.P. (now known as Court Square Capital Partners, but referred to herein as CVC ), Francisco Partners L.P., or Francisco Partners, CVC Asia Pacific Limited, or CVC Asia Pacific, certain members of management and other investors, following discussions with

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Hynix that began in late 2001 and the execution of a definitive agreement in June 2004. Previously, we were the System IC division within Hynix which, in 1999, had been formed from the Hyundai Electronics and LG Semiconductor System IC businesses and can trace its history back to the late 1970s. We refer to the acquisition transaction, including the related definitive agreements with Hynix, as the Original Acquisition.

### **Divestment of Application Processor Business**

On January 31, 2006, we completed the sale of our application processor business to ABOV Semiconductor Co., Ltd., a new independent entity formed by the investors in GreenChips Co., Ltd., a Korean semiconductor solution provider. The application processor business primarily included assets, staff, and intellectual property related to MagnaChip's 8-bit and 32-bit microcontroller, SmartCard controller, microperipheral IC, and linear IC product lines. MagnaChip retained a 2.3% equity stake in the new entity, and our semiconductor manufacturing services business continues to provide wafer foundry services for ABOV Semiconductor.

### **Competitive Strengths**

We believe that our competitive strengths include:

*Leading Technology and Intellectual Property.* We believe our advanced process technology and portfolio of approximately 8,500 registered and pending patents provide us with key competitive advantages in the following areas:

*CMOS image sensors:* Our CMOS image sensors feature low power consumption and currently up to 3.2 megapixel resolution with auto-focus and auto-zoom options; features which provide important benefits to products incorporating our solutions, including increased battery life, enhanced image quality and ease of use.

*Flat panel display drivers:* We believe that our flat panel display drivers offer superior performance in shaping image signals and transmitting those signals to flat panel displays. These technical features result in sharper, brighter and higher-quality colored images in our customers' end products. Furthermore, we believe that our flat panel display drivers enable thinner and more power-efficient flat panels that are easily integrated by our customers into their products.

*Semiconductor manufacturing services:* We have developed high-voltage, analog power and embedded memory specialty manufacturing process technologies that enable us to manufacture differentiated, high performance integrated semiconductor devices. For example, we developed the first high-voltage, high-performance CMOS 0.18  $\mu\text{m}$  process, which enables us to manufacture more integrated, and thus smaller and more cost-efficient, semiconductor products. We believe that our proprietary process technology allows us to meet a wide variety of the specialty semiconductor manufacturing needs of our customers.

*Flexible In-House Manufacturing.* Our in-house wafer manufacturing capacity allows us to provide dependable delivery and quality of integrated semiconductor products to our customers. We have the ability to ramp quickly to high volumes to meet the variable needs of our customers. We have significant wafer manufacturing capacity as a result of our former parent's investments in our wafer fabrication facilities. Because we offer specialty process technologies that do not require expensive investment in leading edge smaller geometry process equipment, we are able to keep our capital expenditures relatively low.

*Significant Cost Advantages.* We maintain price competitiveness on our products through our low cost operating structure. The Asian location of our primary manufacturing and research and development facilities provides us with a number of cost advantages relative to operating in other regions in the world. Additionally, we believe that our history of competing in the highly cost-sensitive markets in which we operated when we were a unit of Hynix required us to refine our manufacturing processes for optimal cost efficiency.

*Established Relationships With Key Consumer Electronics OEMs.* Our long history of operating in Asia and our proximity to leading communications and consumer OEMs facilitate our close customer relationships with

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leading innovators in the consumer electronics market. We have active local applications and engineering work support programs for our customers and collaborate closely with our customers in the design and manufacturing of their products.

*Significant Management and Board Expertise.* Our management and Board of Directors have significant previous experience with advanced semiconductor companies both in Asia and worldwide. Our executives have many years of experience at such leading companies as Hynix, Samsung, Fairchild Semiconductor, and ChipPAC. In addition, two of our equity sponsors, CVC and Francisco Partners, have a long history of investments in semiconductor companies. We believe that their understanding of semiconductor system solutions, relationships, and credibility with key customers provides us with a key competitive advantage.

### **Business Strategy**

Our goal is to build upon our position as a leading provider of mixed-signal and digital multimedia semiconductors addressing the convergence of consumer electronics and communications devices. Our business strategy emphasizes the following key elements:

*Leverage Our Substantial Intellectual Property.* We intend to use our broad patent portfolio and specific end market expertise to deliver system-level products with higher levels of integration and performance to customers in our existing and new markets. In CMOS image sensors, we intend to leverage our strong pixel design and manufacturing expertise to introduce higher resolution, more integrated and cost-effective solutions for camera-equipped mobile handsets and to penetrate emerging applications for image sensors in the automotive, medical and industrial markets over time. In flat panel display drivers, we intend to leverage our broad library of circuit building blocks, our embedded memory capabilities, our understanding of the major flat panel display types and our process technology to continue to reduce time to market and introduce new products that enhance image quality and operate with greater power efficiency. Our manufacturing process expertise and related intellectual property underlies and supports many of the advances in our technology.

*Strengthen Collaboration With Key Customers.* We intend to continue strengthening and deepening relationships with our key customers by collaborating on critical design and product development roadmaps. We believe such collaborative relationships will solidify our position with our customers, further our competitive differentiation and accelerate our drive for deeper customer and new market penetration. For example, close collaboration with our mobile handset customers has allowed us to deliver improved interfaces between baseband and image processors, which have resulted in solutions with smaller form factors and improved image quality.

*Increase Large Account Penetration.* We have a global customer base consisting of leading consumer electronics OEMs and contract manufacturers. Many of our customers have multiple product variations that use image-capture and processing. We will seek to increase our customer penetration by taking advantage of our broad product portfolio and existing relationships to cross-sell existing products to our customers and to penetrate product variations where our solutions are currently not used.

*Broaden Our Customer Base.* We intend to expand our customer base across various applications and geographic locations by leveraging our position as a supplier to many of the largest global consumer electronics companies and delivering to potential customers proven, innovative solutions. We also believe that as consumer electronics and communications applications converge and proliferate, we will increasingly have opportunities to sell our products into new markets such as the automotive, medical and industrial markets. We also intend to expand our global sales presence to penetrate new accounts worldwide and grow existing account relationships. We will leverage our sales representatives and distributors located throughout Asia, the United States, and Europe to further these goals.

*Leverage Our Capital Light Business Model.* We acquired significant proprietary process technologies and wafer manufacturing capacity from our former parent, Hynix. We intend to leverage these investments made by



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Hynix to drive our growth and margin improvement. Furthermore, we plan to continue to keep our capital expenditures relatively low by maintaining our focus on specialty process technologies that do not require expensive investment in leading edge technologies. If needed, we will access other foundries that provide such technology in the future. We believe this approach will lead to a higher return on invested capital.

### **Products and Services**

We have a balanced portfolio of products that address many of the most rapidly growing consumer electronics markets. We have determined, based on the nature of our operations and products offered to customers, that our reportable segments are Imaging Solutions, Display Solutions, and Semiconductor Manufacturing Services. The Imaging Solutions segment's primary products are CMOS image sensors, and the Display Solutions segment's primary products are flat panel display drivers. The Semiconductor Manufacturing Service segment provides wafer foundry services to clients.

*Imaging Solutions.* Our highly integrated image sensors are designed to be cost effective and to provide brighter, sharper, more colorful and, thus enhanced, image quality for use primarily in applications that require small form factors, low power consumption, effective heat dissipation and high reliability. Our image sensors fully satisfy these key criteria and are used in image capture applications such as camera-equipped mobile handsets and personal computer cameras. Our in-house manufacturing capabilities enable us to continuously fine tune our CMOS process technology to deliver improved image-capture sensitivity and accuracy.

CMOS image sensors are typically less expensive to produce and consume less power than other types of image sensors. Historically, CMOS image sensors were primarily used for low-cost applications for which high-image quality was not a priority. Recently, advances in semiconductor manufacturing processes and design techniques have led to improvements in CMOS image sensor performance and quality. As a result, CMOS image sensors have become useful, relatively low-cost solutions for use in applications such as camera-equipped mobile handsets and PDAs, where high-image quality, low power consumption, small size and low-cost are important considerations.

According to iSuppli, total worldwide image sensor revenue is expected to grow from \$6.56 billion to \$9.146 billion from 2006 to 2010, while unit shipments for area sensors such as our products will grow from 919 million units in 2006 to 1.538 billion units in 2010. Image sensor revenues for wireless electronics are forecasted by iSuppli to grow from 29% of the total revenue in 2006 to 64% by 2010. Conversely, revenues for consumer electronics will drop from 45% to 18% of the total market. Handsets accounted for 70% of all image sensor unit shipments in 2005 and will increase at a compound annual growth rate of 20% to account for 77% of all sensor shipments by 2010. Importantly, sensors for digital still cameras will only increase at a 5.8% compound annual growth rate from 98 million units in 2005, or 14.5% of the total, to 130 million units in 2010, or 8.4% of the total.

Our CMOS image sensors are characterized by a high level of integration. Many CMOS image sensors systems are made up of at least two integrated circuits: 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 has become an increasingly important consideration for manufacturers of camera phones and similar products. Our products meet this demand for smaller form factors by integrating both our proprietary image sensor and image signal processor onto a single chip, thus occupying approximately half of the space required by multiple chip solutions, while providing equivalent or even superior image quality with lower power consumption and a lower overall cost.

We offer CMOS image sensors with resolutions of VGA, 1.0MP (megapixels), 1.3MP, 2.1MP and 3.2MP. Our solutions enable small form factor camera module implementations which are required for today's demanding industrial designs, such as very thin mobile phones. All of our solutions support both video and still capture modes, and provide sub-sampling modes to enable preview modes of operation with reduced power.

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consumption. The choice of resolution by an OEM customer may involve many factors such as size, power and cost target. By offering a full line of solutions, we can service our customer's requirements across the multiple end products they may offer.

Our imaging solutions segment received revenues of \$60.5 million and had a gross loss of \$4.0 million during the year ended December 31, 2006, revenues and gross profit of \$163.3 million and \$25.4 million during the year ended December 31, 2005, and revenues and gross profit of \$58.1 million and \$12.7 million during the three-month period ended December 31, 2004.

*Display Solutions.* Our flat panel display driver solutions are used in a wide variety of displays for mass market and commercial applications such as mobile handsets, handheld gaming devices, PDAs, displays for desktop and mobile computer monitors and flat panel televisions. We produce highly integrated flat panel display driver solutions and have pioneered developments in embedded memory and in the design and manufacturing of display drivers, enabling our customers to provide improved picture quality through thinner, smaller, more power-efficient displays.

Display drivers are the critical semiconductor components that enable the display's functionality. A display driver operates by interfacing with the host processor to generate the precise analog voltages and currents required to create images on the display. The performance characteristics of a display driver are critical to the quality and visual appeal of the images and text generated on the display and, in mobile devices, the power efficiency of the device. Our display drivers are highly integrated semiconductors that are customized for the particular needs of our customers. We believe that our design engineering expertise, technology leadership, manufacturing process expertise and library of functional building blocks produce display drivers that enable a wide variety of display types with high-impact visual performance.

The overall end market for flat panel display drivers is composed of a multitude of consumer electronics device markets such as television, laptop and desktop computers and portable consumer devices, including mobile handsets. This overall market can be broken down into several distinct sub-markets which we serve. These sub-markets include large panel TFTs, typically used in flat panel televisions and computer displays, small panel TFTs, typically used in mobile handsets, OLEDs and Color STNs. iSuppli forecasts in the Display Driver ICs Market Tracker that small and medium flat panel display producer shipments will increase from approximately 1.897 billion units in 2006 to 2.226 billion units by 2010, a compound annual growth rate of 4.1%. DisplaySearch forecasts the large TFT LCD market size to increase from 258 million units and \$96 billion revenue in 2006 to 462 million units and \$138 billion revenue in 2010, a compound annual growth rate of 16%.

We provide display drivers for use in several different types of display technologies and for a variety of end-market applications as discussed below.

*TFT-LCD.* TFT is an advanced active matrix LCD technology that uses a matrix of transistors embedded on a thin film of silicon to change the transparency of the LCD when voltage is applied. TFT-LCD technology is currently widely used for notebook computers and large scale flat panel monitors (Large TFT) as well as for displays for high-end mobile devices such as advanced mobile handsets (Small TFT). We currently provide Large TFT display drivers for use in mobile and desktop computer displays and in stand-alone flat panel television displays. We also provide Small TFT display drivers for use in mobile handsets, PDAs and in other consumer devices such as handheld gaming devices.

*Color STN.* Color STN is a low-power, low-cost solution based on passive matrix LCD technology and is widely used in color mobile displays available in the market today. Our Color STN display drivers are used in mobile applications such as mobile handsets, PDAs and handheld gaming devices.

*Organic Light Emitting Diode or OLED.* OLED is a relatively new display technology used in both mobile displays as well as in larger displays. OLED technology provides enhanced picture quality, low power consumption and long product life; it also has fast image response time, making it an ideal solution

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for displaying motion pictures on mobile devices. We currently offer display drivers for OLED displays used in mobile handsets and other mobile devices.

Our display solutions segment received revenues of \$273.7 million and gross profit of \$35.6 million during the year ended December 31, 2006, \$326.1 million and \$66.6 million during the year ended December 31, 2005, and \$60.3 million and \$4.5 million during the three-month period ended December 31, 2004.

*Semiconductor Manufacturing Services.* We provide semiconductor manufacturing services primarily to semiconductor companies that do not have their own fabs. We target the market for diversified semiconductor products that require differentiated specialty process technologies for their manufacture, including high-voltage CMOS, non-volatile memory processes, power, analog and mixed-signal processes. We focus on specialty process technologies that do not require significant recurring capital investment, and we are able to better differentiate ourselves through the depth of our intellectual property portfolio and process technology skills.

The increasing trend toward the outsourcing of semiconductor manufacturing has resulted in a rapid increase in the size of this market. According to iSuppli, the worldwide foundry service market is projected to grow from in excess of \$26.6 billion in 2006 to \$44.3 billion in 2010, a compound annual growth rate of 13.6%.

Typical applications serviced by our semiconductor manufacturing services business are high-voltage, analog and mixed-signal, power, and non-volatile memory products for consumer, data processing, mobile, game and data communication end-markets. We have developed specialty manufacturing process technologies that enable us to manufacture differentiated, high-performance integrated semiconductor devices. For example, we developed a distinctive high-voltage, high-performance CMOS 0.18  $\mu\text{m}$  process that enables us to manufacture more integrated, and thus smaller and more cost efficient, semiconductor products. We believe that our proprietary process technology allows us to meet a wide variety of the specialty semiconductor manufacturing needs of our customers.

Our internal wafer fab facilities serve both our in-house product design groups and external foundry customers, allowing for both specialty process technology expertise and flexible manufacturing capacity. We target to be the primary-source provider of semiconductor manufacturing services for specialty process technologies for our foundry customers.

Our semiconductor manufacturing services segment received revenues of \$342.4 million and gross profit of \$45.7 million during the year ended December 31, 2006, \$345.4 million and \$110.4 million during the year ended December 31, 2005, and \$88.3 million and \$19.1 million during the three-month period ended December 31, 2004.

## **Customers**

During the year ended December 31, 2006, we sold over 2,200 products to more than 240 customers. In the year ended December 31, 2006, our 10 largest customers accounted for approximately 65.6% of our net sales, and we had one customer, a group of LG affiliates including LG.Philips LCD, representing greater than 10% of our net sales. See Risk Factors A significant portion of our sales comes from a relatively limited number of customers.

Revenue classified by geography is determined by the headquarters locations of our customers. During the year ended December 31, 2006, we received revenues of \$62.3 million from external customers in the United States and \$682.0 million from all foreign countries, of which 60.7% was from Korea, 11.5% from Japan, 17.4% from Taiwan, and 7.5% from China, Hong Kong, and Macau. During the year ended December 31, 2005, we received revenues of \$45.5 million from external customers in the United States and \$892.2 million from all foreign countries, of which 57.4% was from Korea, 11.0% from Japan, 16.0% from Taiwan, and 11.8% from China, Hong Kong, and Macau. During the three-month period ended December 31, 2004, we received revenues of \$9.3 million from external customers in the United States and \$234.3 million from all foreign countries, of

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which 54.3% was from Korea, 16.2% from Japan, 12.8% from Taiwan, and 13.5% from China, Hong Kong, and Macau.

### **Sales, Marketing and Distribution**

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 concentrations of major customers. Our direct sales force consists primarily of representatives located in our headquarters in Korea, as well as representatives located elsewhere throughout Asia, the United States, and Europe. 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. During the year ended December 31, 2006, we derived approximately 74% of net sales through our direct sales force and 26% of net sales through our network of authorized agents and distributors.

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 headquarters for fulfillment. Our agreements with our authorized agents and distributors are usually terminable by either party on relatively short notice.

### **Research and Development**

Our expenditures for research and development were \$131.2 million, representing 17.6% of net sales for the year ended December 31, 2006, \$107.6 million, representing 11.5% of net sales for the year ended December 31, 2005, and \$97.8 million, representing 9.0% of net sales for the year ended December 31, 2004. Our research and development efforts focus on process technology, design methodology and intellectual property for our semiconductor products and foundry services. As a result, we have implemented improvements to our manufacturing processes, design software and design libraries, including our 0.15  $\mu\text{m}$  high-voltage process and our 0.13  $\mu\text{m}$  CIS process and library. We also work closely with our major customers in many research and development activities, including joint intellectual property development, to increase the likelihood that our products will be more easily designed into the customers' products and consequently achieve rapid and lasting market acceptance. In CMOS image sensors, we are focusing on pixel size reduction, thereby enabling smaller form factors and higher resolution sensors. In flat panel display drivers, we are focusing on further integration. In semiconductor manufacturing services, our research and development work allows us to add features such as mixed-signal, high voltage, embedded memory and power devices.

### **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 chemicals, gases, and tape, which is one of the process materials for our display drivers. We continue to attempt to qualify additional suppliers for these materials. Although we have not experienced any significant raw material shortages in the past, it is possible that going forward our business and results of operations could be adversely affected due to supply shortages or price increases for raw materials.

Worldwide supplies of silicon wafers, an important raw material for the semiconductors we manufacture, have been decreasing due to a worldwide shortage of polysilicon, the raw material of wafers, and are not expected to increase until late 2008. Polysilicon is also a key raw material for solar cells, the demand for which has steadily increased over the last two years.

### **Intellectual Property**

As of March 1, 2007, our portfolio of intellectual property assets included approximately 8,500 registered and pending patents. Our patents expire at various times over the next 18 years. While these patents are in the aggregate important to our competitive position, no single registered or pending patent is material to us.

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Pursuant to the intellectual property license agreement that we entered into with Hynix in connection with the Original Acquisition, we obtained from Hynix a non-exclusive license to certain intellectual property of Hynix that is mostly patent-related, and we granted to Hynix a non-exclusive license to certain of our intellectual property. Additionally, 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 ARM's ARM7 and ARM9 core-based System-on-Chip.

In addition, we rely on proprietary know-how, continuing technological innovation and other trade secrets to develop products and maintain our competitive position. We attempt to protect our proprietary know-how and our other trade secrets by executing, when appropriate, confidentiality agreements with our customers and employees. We cannot assure you that our competitors will not discover comparable or the same knowledge and techniques through independent development or other means.

## **Competition**

We operate in highly competitive markets. 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 manufacturers and designers of system semiconductors, standard products, and semi-standard programmable digital logic semiconductor products, as well as customers who design their own semiconductors that are manufactured at third party foundries.

We compete with other semiconductor providers based on design experience, the ability to service customer needs from the design phase to the shipping of a completed product, length of design cycle, longevity of technology support and sales and technical support personnel. Our ability to successfully compete depends on internal and external variables, both within and outside of our control. These variables include, but are not limited to, the timeliness with which we can develop new products and technologies, product performance and quality, manufacturing yields and availability, customer service, pricing, industry trends and general economic trends.

## **Employees**

Our worldwide workforce consisted of 3,504 employees (full- and part-time) as of March 1, 2007, of which 455 were involved in sales, general and administrative, 485 were in research and development, 92 were in quality, reliability and assurance and 2,472 were in manufacturing (comprised of 401 in engineering and 2,071 in operations). As of March 1, 2007, 2,149 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.

Currently, members of the Korean Confederation of Trade Unions (KCTU), representing the former employees of two subcontractors that we retained for only three months in 2004, have demonstrated and may continue to demonstrate at our campus in Cheongju, Korea. The KCTU is demanding that we pressure other subcontractors to hire the employees and that we pay monetary compensation to the employees. These demonstrations have required additional interim expenses and may have a continuing negative impact on our operations in the future.

## **Environmental Matters**

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)

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and wastes, soil and groundwater contamination and employee health and safety. These laws and regulations are complex, constantly changing and have tended to become more stringent over time. We cannot assure you that we have been, or will be at all times, in complete compliance with all these laws and regulations or that we will not incur material costs or liabilities in connection with these laws and regulations in the future. The adoption of new environmental, health and safety laws, the failure to comply with new or existing laws, or issues relating to hazardous substances could subject us to material liability (including substantial fines or penalties), impose the need for additional capital equipment or other process requirements upon us, curtail our operations, or restrict our ability to expand operations.

### **For More Information**

We file periodic reports with the Securities and Exchange Commission. Copies of our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q, and Current Reports on Form 8-K, including any amendments to these reports, are available on our website at [www.magnachip.com](http://www.magnachip.com). The public may also read and copy any materials we file with the SEC at the SEC's Public Reference Room at 100 F Street, NE, Washington, D.C. 20549, or on the SEC's website at [www.sec.gov](http://www.sec.gov). For information on the operation of the Public Reference Room, please call the SEC at 1-800-SEC-0330.

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

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

The semiconductor industry is highly cyclical and periodically experiences significant economic downturns characterized by diminished product demand, resulting in production overcapacity and excess inventory in the markets we serve, which can result in rapid erosion of average selling prices. The industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product cycles of both semiconductor companies and their customers' products and the decline in general economic conditions.

We have experienced these conditions in our business in the past and may experience renewed, and possibly more severe and prolonged, downturns in the future as a result of such cyclical changes. This may reduce our profitability and the value of our business.

#### **Customer demand is difficult to accurately forecast.**

We make significant decisions, including determining the levels of business that we will seek and accept, production schedules, component procurement commitments, personnel needs and other resource requirements, based on our estimates of customer requirements. The short-term nature of commitments by many of our customers and the possibility of rapid changes in demand for their products reduces our ability to accurately estimate future customer demand. On occasion, customers may require rapid increases in production, which can challenge our resources and reduce margins. We may not have sufficient capacity at any given time to meet our customers' increased demand for our product. Conversely, downturns in the semiconductor industry may cause and have caused our customers to significantly reduce the amount of products ordered from us. Because many of our costs and operating expenses are relatively fixed, a reduction in customer demand may decrease our gross margins and operating income.

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

We generally do not obtain firm, long-term purchase commitments from our customers. Customers may cancel their orders, change production quantities or delay production for a number of reasons. Cancellations, reductions or delays by a significant customer or by a group of customers, which we have experienced as a result of the recent downturn in the semiconductor industry, have adversely affected and may continue to adversely

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affect our results of operations. In addition, while we do not obtain long-term purchase commitments, we generally agree to the pricing of a particular product for the entire lifecycle of the product, which can extend over a number of years. If we underestimate our costs when determining the pricing, our margins and results of operations would be adversely affected.

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

If we were to lose key customers or if customers cease to place orders for our high volume devices, our financial results will be adversely affected. While we served more than 240 customers in the twelve-month period ended December 31, 2006, net sales to our 10 largest customers represented approximately 65.6% of our net sales for the period. We had one individual customer and one group of affiliated customers that each represented greater than 10% of our net sales during the year ended December 31, 2006. Significant reductions in sales to any of these customers, the loss of major customers or the curtailment of orders for our high-volume devices within a short period of time would adversely affect our business.

### **Our industry is highly competitive.**

The semiconductor industry is highly competitive and includes hundreds of companies, a number of which have achieved substantial market share. Current and prospective customers for our products evaluate our capabilities against the merits of our direct competitors. Some of our competitors are well-established as independent companies and have substantially greater market share and manufacturing, financial, research and development and marketing resources than we do. We also compete with emerging companies that are attempting to sell their products in specialized markets, and with the internal capabilities of many of our significant customers. We expect to experience continuing competitive pressures in our markets from existing competitors and new entrants. Any consolidation among our competitors could enhance their product offerings and financial resources, further enhancing their competitive position. Our ability to compete successfully depends on a number of factors, including the following: our ability to offer cost effective products on a timely basis using our technologies; our ability to accurately identify and respond to emerging technological trends and demand for product features and performance characteristics; product introductions by our competitors; our ability to adopt or adapt to emerging industry standards; and the number and nature of our competitors in a given market. Many of these factors are outside of our control. In the future, our competitors may capture our existing or potential customers and our customers may satisfy more of their requirements internally. As a result, we may experience declining revenues and profits.

### **A decline in average selling prices could decrease our profits.**

In the past, our industry has experienced a decline in average selling prices. A decline in average selling prices for our products, if not offset by reductions in the costs of producing such products, would decrease our gross profits and could have a material adverse effect on our business, financial condition and results of operations.

### **Growth in the consumer electronics and other end markets for our products is an important component in our success.**

Our continued success will depend in part on the growth of various consumer electronics markets and other end markets that use our semiconductors and on general economic growth. To the extent that we cannot offset recessionary periods or periods of reduced growth that may occur in these markets through greater penetration of these markets, our sales may decline and our business, financial condition and results of operations may suffer as a result.

### **We depend on successful technological advances for growth.**

Our industry is subject to rapid technological change and product obsolescence as customers and competitors create new and innovative products and technologies. Products or technologies developed by other

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companies may render our products or technologies obsolete or noncompetitive and we may not be able to access leading edge process technologies or to license or otherwise obtain essential intellectual property required by our customers. Our inability to continue identifying new product opportunities, or manufacturing technologically advanced products on a cost-effective basis, may result in decreased revenues and a loss of market share to our competitors.

### **We may not be able to attract or retain the technical or management employees necessary to remain competitive in our industry.**

We depend on our ability to attract and retain skilled technical and managerial personnel. We could lose the services of, or fail to recruit, skilled personnel, which could hinder our research and product development programs or otherwise have a material adverse effect on our business.

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

As of March 1, 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 cannot assure you that issues with the labor union and other employees will be resolved favorably for us in the future, that we will not experience significant work stoppages in future years or that we will not record significant charges related to those work stoppages.

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

As part of our business strategy, we may seek to enter into business combinations, investments, joint ventures and other strategic alliances with other companies in order to maintain and grow revenue and market presence as well as to provide us with access to technology, products and services. Those transactions would be accompanied by risks that may harm our business, such as difficulties in assimilating the operations, personnel and products of an acquired business or in realizing the projected benefits; disruption of our ongoing business; potential increases in our indebtedness and contingent liabilities; and charges if the acquired company or assets are later worth less than the amount paid for them in the Original Acquisition. In addition, our senior secured credit facility and the indentures governing our notes may prohibit us from making acquisitions that we may otherwise wish to pursue.

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

As many of our costs are fixed, a reduction in capacity utilization, together with other factors such as yield and product mix, could reduce our profit margins and adversely affect our operating results. A number of factors and circumstances may reduce utilization rates, including periods of industry overcapacity, low levels of customer orders, operating inefficiencies, mechanical failures and disruption of operations due to expansion or relocation of operations, power interruptions, fire, flood or other natural disasters or calamities.

### **The failure to achieve acceptable manufacturing yields could adversely affect our business.**

The manufacture of semiconductors requires precision, a highly-regulated and sterile environment and expensive equipment. We may have difficulty achieving acceptable yields in the manufacture of our products. Slight impurities or defects in the masks used to print circuits on a wafer or other factors can cause significant difficulties, particularly in connection with the production of a new product, the adoption of a new manufacturing process or any expansion of our manufacturing capacity and related transitions.



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### **We rely on certain subcontractors.**

The majority of our net sales are derived from semiconductor devices assembled in advanced packages. The packaging of semiconductors is a complex process requiring, among other things, a high degree of technical skill and advanced equipment. We outsource our semiconductor packaging to subcontractors, most of which are located in Korea and Southeast Asia. We rely on these subcontractors to package our devices with acceptable quality and yield levels. If our semiconductor packagers experience problems in packaging our semiconductor devices or experience prolonged quality or yield problems, our operating results could be adversely affected.

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

We use a wide range of parts and materials in the production of our semiconductors, including silicon, processing chemicals, processing gases, precious metals and electronic and mechanical components. We procure materials and electronic and mechanical components from domestic and foreign sources and original equipment manufacturers. If we cannot obtain adequate materials in a timely manner or on favorable terms for the manufacture of our products, either or both of our revenues or profits will decline.

### **We face product liability risks and the risk of negative publicity if our products fail.**

Our semiconductors are incorporated into a number of end products, and our business is exposed to product liability risk and the risk of negative publicity if our products fail. Although we maintain insurance for product liability claims, the amount and scope of our insurance may not be adequate to cover a product liability claim that is asserted against us. In addition, product liability insurance could become more expensive and difficult to maintain and, in the future, may not be available on commercially reasonable terms or at all.

In addition, we are exposed to the product liability risk and the risk of negative publicity affecting our customers and suppliers. Our sales may decline if any of our customers are sued on a product liability claim. We may also suffer a decline in sales from the negative publicity associated with such a lawsuit or with adverse public perceptions in general regarding our customers' products.

### **Our ability to compete successfully and achieve future growth will depend, in part, on our ability to protect our proprietary technology, as well as our ability to operate without infringing the proprietary rights of others.**

We seek to protect our proprietary technologies and know-how through the use of patents, trade secrets, confidentiality agreements and other security measures. The process of seeking patent protection takes a long time and is expensive. We cannot assure you that patents will issue from pending or future applications or that, if patents issue, they will not be challenged, invalidated or circumvented, or that the rights granted under the patents will provide us with meaningful protection or any commercial advantage. Some of our technologies are not covered by any patent or patent application. The confidentiality agreements on which we rely may be breached and may not be adequate to protect our proprietary technologies. We cannot assure you that other countries in which we market our services will protect our intellectual property rights to the same extent as the United States.

Our ability to compete successfully depends on our ability to operate without infringing the proprietary rights of others. We have no means of knowing what patent applications have been filed in the United States until they are published. In addition, the semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. Litigation, which could result in substantial costs to us and diversion of our resources, may also be necessary to enforce our patents or other intellectual property rights or to defend against claimed infringement of the rights of others. In the event of an adverse outcome in any such litigation, we may be required to pay substantial damages, indemnify customers or licensees for damages they may suffer if the products they purchase from us or the technology they license from us violate the intellectual property rights of

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others; stop our manufacture, use, sale or importation of infringing products; expend significant resources to develop or acquire non-infringing technologies; discontinue processes; or obtain licenses to the intellectual property we are found to have infringed. We cannot assure you that we would be successful in such development or acquisition or that such licenses would be available under reasonable terms, or at all.

Our competitors may develop, patent or gain access to know-how and technology similar to our own. Failure to protect our existing intellectual property rights may result in the loss of valuable technologies or our having to pay other companies for infringing on their intellectual property rights.

### **We are subject to many environmental laws and regulations that could affect our operations or result in significant expenses.**

We are subject to requirements of environmental, health and safety laws and regulations in each of the jurisdictions in which we operate, governing, among other things, air emissions, wastewater discharges, the generation, use, handling, storage and disposal of, and exposure to, hazardous substances (including asbestos) and wastes, soil and groundwater contamination and employee health and safety. These laws and regulations are complex, constantly changing and have tended to become more stringent over time. We cannot assure you that we have been, or will be at all times, in complete compliance with all these laws and regulations or that we will not incur material costs or liabilities in connection with these laws and regulations in the future. The adoption of new environmental, health and safety laws, the failure to comply with new or existing laws, or issues relating to hazardous substances could subject us to material liability (including substantial fines or penalties), impose the need for additional capital equipment or other process requirements upon us, curtail our operations, or restrict our ability to expand operations.

### **We could suffer adverse tax and other financial consequences as a result of changes in, or differences in the interpretation of, applicable tax laws.**

Our company organizational structure is based, in part, on assumptions about the various tax laws, including withholding tax, and other laws of applicable non-U.S. jurisdictions. In addition, our Korean subsidiary ( MagnaChip Korea ) was granted a limited tax-holiday under Korean law in October 2004, which provides for certain tax exemptions for corporate taxes, withholding taxes, acquisition taxes, property and land taxes and other taxes for five years. Our interpretations and conclusions are not binding on any taxing authority, and, if our assumptions about tax and other laws are incorrect or if the authorities were to change or modify the relevant laws, we could suffer adverse tax and other financial consequences or have the anticipated benefits of our company organizational structure materially impaired.

### **A limited number of persons indirectly control us.**

CVC, Francisco Partners, and CVC Asia Pacific own approximately 34.1%, 34.1% and 18.3%, respectively, of the outstanding voting interests in MagnaChip. By virtue of their ownership of these voting interests, and the securityholders' agreement among MagnaChip and its unitholders, these entities have significant influence over our management and will be able to determine the outcome of all matters required to be submitted to the unitholders for approval, including the election of a majority of our directors and the approval of mergers, consolidations and the sale of all or substantially all of our assets.

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

We may require more capital in the future to fund our operations, finance investments in equipment and infrastructure, and respond to competitive pressures and potential strategic opportunities. Additional capital may not be available when needed or, if available, may not be available on satisfactory terms. If we are unable to obtain capital on favorable terms, or if we are unable to obtain capital at all, we may have to reduce our operations or forego opportunities and it may have a material adverse effect on our business, financial condition and results of operations.

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### **Our international operations are subject to various risks that may lead to decreases in financial results.**

We face risks inherent in international operations, such as unexpected changes in regulatory requirements, tariffs and other market barriers, political, social and economic instability, adverse tax consequences, war, civil disturbances and acts of terrorism, difficulties in accounts receivables collection, extended payment terms and differing labor standards, enforcement of contractual obligations and protection of intellectual property. These risks may lead to increased costs or decreased revenue growth, or both.

### **Any increase in tensions with North Korea could adversely affect our business, financial condition, and results of operations.**

Relations between Korea and North Korea have been tense throughout Korea's modern history. The level of tension between Korea and North Korea has fluctuated and may increase or change abruptly as a result of current and future events. Although we do not derive any revenue from, nor sell any products in, North Korea, any future increase in tensions which may occur, for example, the breakdown of high-level contacts between Korea and North Korea or the occurrence of military hostilities, could adversely affect our business, financial condition and results of operations.

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

Our revenues are denominated in various currencies, specifically, the Korean Won, Japanese Yen, Euro and U.S. dollar. As a result, changes in the exchange rates of these currencies or any other applicable currencies to the U.S. dollar will affect the translated price of products and therefore operating margins and could result in exchange losses.

The majority of our costs are denominated in Korean Won and to a lesser extent in Japanese Yen, U.S. dollar and Euro. Therefore, changes in the exchange rates of these currencies or any other applicable currencies to the U.S. dollar will affect cost of goods sold and operating margins and could result in exchange losses.

We cannot fully predict the impact of future exchange rate fluctuations on our profitability. From time to time, we may have engaged in, and may continue to engage in, exchange rate hedging activities in an effort to mitigate the impact of exchange rate fluctuations. However, we cannot assure you that any hedging technique we implement will be effective. If it is not effective, we may experience reduced operating margins.

### **Our historical financial information may not be representative of our results as a separate company.**

Prior to the Original Acquisition, we operated as a division of Hynix. Historical financial information for periods prior to September 30, 2004, was derived from Hynix's consolidated financial statements, has been presented on a carve-out basis and does not necessarily reflect what our financial position, results of operations or cash flows would have been had we been a separate, stand-alone company during the periods presented. As carve-out financial statements, the financial statements include allocations of the costs of shared activities and overhead of Hynix and of intangible assets and property, plant and equipment shared with Hynix. These allocations are based upon various assumptions and estimates, some of which are subjective. Actual results of our operations had we operated on a stand-alone basis, may differ from those allocations and estimates. Also, as part of the Original Acquisition we did not acquire certain assets that were included in the carve-out financial statements and we assumed certain additional costs and obligations that are not reflected in the carve-out financial statements. Accordingly, the carve-out financial statements should not be relied upon as being representative of our financial position or operating results had we operated on a stand-alone basis, nor may they be representative of our financial position or operating results following the Original Acquisition.

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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.**

Because we share certain facilities with Hynix, a few services that are essential to our business are provided to us by or through Hynix. These services include electricity, bulk gasses and de-ionized water, campus facilities, wastewater and sewage management, and environmental safety. If any of our agreements with Hynix were terminated or if Hynix were unwilling or unable to fulfill its obligations to us under the terms of these agreements, we would have to procure these services on our own and as a result may experience an increase in our expenses.

In addition, we lease building and warehouse space from Hynix in Cheongju, Korea, and lease to Hynix some of the space we own in Cheongju, Korea. If Hynix were to become insolvent, we could lose our leases on some of our building and warehouse space.

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

We invest significant resources in our research and development. However, research and development efforts may not yield commercially viable products. During each stage of research and development there is a substantial risk that we will have to abandon a potential product which is no longer marketable and in which we have invested significant resources. In the event we are able to develop viable new products, a significant amount of time will have elapsed between our investment in the necessary research and development effort and the receipt of any related revenues.

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

Beginning with our fiscal year ending December 31, 2007, we will be subject to rules adopted by the SEC pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, which require us to include in our Annual Report on Form 10-K our management's report on, and assessment of the effectiveness of, our internal controls over financial reporting. Beginning with our fiscal year ending December 31, 2008, our independent auditors will be required to attest to and report on management's assessment of the effectiveness of our internal controls over financial reporting. If we fail to achieve and maintain the adequacy of our internal controls, there is a risk that we will not comply with all of the requirements imposed by Section 404. Moreover, effective internal controls, particularly those related to revenue recognition, are necessary for us to produce reliable financial reports and are important to helping prevent financial fraud. Any of these possible outcomes could result in an adverse reaction in the financial marketplace due to a loss of investor confidence in the reliability of our financial statements, which ultimately could harm our business and could negatively impact the market price of our securities.

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

Not Applicable.

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

We own and operate five wafer fabrication facilities, or fabs, which have a combined production capacity of over 119,000 eight-inch equivalent wafers per month. We manufacture wafers at our two 8-inch fabs and our 6-inch fab located in Cheongju, Korea and our 8-inch fab and our 5-inch fab located in Gumi, Korea. The Cheongju facilities have three main buildings totaling 164,058 square meters. The Gumi facilities have two main buildings with 50,351 square meters devoted to manufacturing. We also lease from Hynix certain exclusive-use space plus certain common- and joint-use space in several buildings, primarily warehouses and utility facilities, in Cheongju, Korea.

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In addition to our fabs located in Cheongju and Gumi, Korea, we lease facilities in Seoul, Korea, Osaka, Japan, and Sunnyvale, California. Each of these facilities includes administration, sales and marketing, research and development, and operations functions. We also lease design facilities in Tokyo, Japan, which also has a sales and marketing office, and 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 that enables us to develop proprietary, differentiated products and maintain a high level of manufacturing control resulting in high production yields, shortened design and production cycles, adequate manufacturing capacity, and the capture of the wafer manufacturing profit margin.

The table below sets forth information with respect to our manufacturing facilities and technologies:

**Manufacturing**

<b>Facility</b>	<b>Location</b>	<b>Wafer Size</b>	<b>Technology</b>
F-5	Cheongju	8	0.18 / 0.15 / 0.13 $\mu$ m
F-4	Cheongju	8	0.35 / 0.25 / 0.22 $\mu$ m
F-3	Gumi	8	0.5 / 0.35 $\mu$ m
F-2	Cheongju	6	0.8 / 0.6 / 0.5 $\mu$ m
F-1	Gumi	5	1.2 $\mu$ m

We outsource most of our back-end manufacturing processes, including assembly, test and packaging to independent providers of these services.

**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 class of common equity as of March 1, 2007, was 206.

*Dividends*

We did not pay any dividends in fiscal year 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*

None.

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The following table sets forth our selected financial and other data as of the dates and periods indicated. The information contained in this table should be read in conjunction with Item 7. Management's discussion and analysis of financial condition and results of operations and our historical financial statements and the accompanying notes thereto included elsewhere in this Form 10-K.

	Year ended December 31		Three months ended	Nine months ended	Year ended	
	2006	2005	December 31,	September 30,	2003	2002
		(Successor Company)(1)	2004	2004	(Predecessor Company)(1)	
	<i>(in millions of US dollars, except unit data)</i>					
<b>Statement of Operations Data</b>						
Net Sales						
Related party(2)	\$	\$	\$	\$	\$	\$
Other	744.3	937.7	243.6	677.8	570.1	393.5
	744.3	937.7	243.6	841.6	830.8	700.3
Cost of sales	644.9	729.0	204.5	654.6	752.5	691.0
Gross profit	99.4	208.7	39.1	187.0	78.3	9.3
Selling, general and administrative	87.7	123.3	29.8	54.0	68.7	61.9
Research and development	131.2	107.6	22.1	75.7	86.6	87.0
Restructuring and impairment charges	94.3	36.2				
Operating income (loss)	(213.8)	(58.4)	(12.8)	57.3	(77.0)	(139.6)
Interest expense, net	(57.2)	(57.2)	(16.7)	(17.7)	(37.8)	(46.8)
Foreign currency gain, net	50.9	16.5	30.4	5.3	1.4	8.6
Other				1.1	1.1	1.3
Other income (expenses)	(6.3)	(40.7)	13.7	(11.3)	(35.3)	(36.9)
Income (loss) before income taxes	(220.1)	(99.1)	0.9	46.0	(112.3)	(176.5)
Income tax expenses	9.2	1.8	6.7	2.8	1.4	1.8
Net income (loss)	\$ (229.3)	\$ (100.9)	\$ (5.8)	\$ 43.2	\$ (113.7)	\$ (178.3)
Dividends to preferred unitholders	10.9	9.9	13.4	N/A	N/A	N/A
Net loss attributable to common units	\$ (240.2)	\$ (110.8)	\$ (19.2)	N/A	N/A	N/A
Net loss per common unit basic and diluted	\$ (4.54)	\$ (2.10)	\$ (0.38)	N/A	N/A	N/A
Weighted average number of units basic and diluted	52,911,734	52,898,497	50,061,910	N/A	N/A	N/A
<b>Balance Sheet Data at period end</b>						
Cash and cash equivalents	\$ 89.2	\$ 86.6	\$ 58.4	\$	\$	\$
Working capital(3)	122.6	141.4	129.3	75.9	21.7	3.1
Total assets	770.1	1,040.6	1,154.5	653.8	790.0	1,077.8
Total indebtedness(4)	750.0	750.0	750.7	252.6	468.1	631.7
Preferred units	117.4	106.5	96.5			

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Owners equity	N/A	N/A	N/A	206.7	155.3	268.3
Unitholders equity	(284.5)	(46.5)	55.9	N/A	N/A	N/A
<b>Foreign exchange rate (KRW/USD)(5)</b>						
Average exchange rate	954.3	1,023.8	1,090.8	1,163.3	1,191.8	1,250.3
End-of-period exchange rate	930.0	1,010.0	1,035.1	1,152.0	1,192.0	1,186.3



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- (1) On October 6, 2004, MagnaChip Semiconductor LLC completed the Original Acquisition. For accounting purposes and consistent with its reporting periods, the Company has used October 1, 2004 as the effective date of the Original Acquisition since the financial results from October 1, 2004 onwards accrued to the Company's benefit. As a result, the Company has reported its 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) Primarily relates to wafer foundry contract manufacturing services to Hynix Semiconductor, Inc., Hynix Display Technology and other related parties during the predecessor company periods when the Company was the System IC division within Hynix.
- (3) Working capital is calculated as current assets less current liabilities.
- (4) Total indebtedness is calculated as long and short-term borrowings, including the current portion of long-term borrowings.
- (5) As a substantial portion of the Company's revenues and assets are recorded in KRW functional currency, conversion to US Dollar reporting currency is required at the end of each reporting period in order to follow the methodology prescribed in SFAS No. 52, *Foreign Currency Translation*.

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

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the federal securities laws that involve risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors set forth elsewhere in this Form 10-K and in the Company's prior public filings with the SEC. These forward looking statements are made based upon management's expectations and beliefs concerning future events impacting the Company and, therefore, involve a number of risks and uncertainties. The Company's management cautions that forward looking statements are not guarantees and that actual results could differ materially from those expressed or implied in the forward looking statements. The following discussion should be read in conjunction with the audited consolidated financial statements and related notes included elsewhere in this Form 10-K. While the Company periodically reassesses material trends and uncertainties affecting the Company's results of operations and financial condition in connection with the preparation of Management's Discussion and Analysis of Financial Condition and Results of Operations and certain other sections contained in the Company's quarterly, annual or other reports filed with the SEC, the Company does not intend to review or revise any particular forward looking statement in light of future events.

#### **Overview**

We are a leading designer, developer and manufacturer of mixed-signal and digital multimedia semiconductors addressing the convergence of consumer electronics and communication devices. We focus our core business on CMOS image sensors and flat panel display drivers, which are complex, high-performance mixed-signal semiconductors that capture images and enable and enhance the features and capabilities of both small and large flat panel displays. We also provide wafer foundry services whereby we leverage our specialized process technologies and low cost manufacturing facilities to produce semiconductors for third parties using their product designs. Our solutions are used in a wide variety of consumer and commercial mass market applications, such as mobile handsets, including camera-equipped mobile handsets, flat panel monitors and televisions, mobile displays, portable computer displays, handheld gaming devices, PDAs and audio-visual equipment such as DVD players.

We have three separate business segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services.

*Display Solutions:* Our Display Solutions segment offers flat panel display drivers for the entire product range of small to large panel displays, including mobile handsets, handheld gaming devices, PDAs, displays for desktop and mobile computer monitors and flat panel televisions. Our products also cover a broad range of technologies and interfaces including LTPS, TFT, CSTN, OLED technologies, RSDS and mini-LVDS interfaces.

*Imaging Solutions:* Our Imaging Solutions segment address a broad spectrum of consumer electronics products ranging from camera-equipped mobile handsets to personal computer webcams, offering VGA, 1.3, 2.1 and 3.2 megapixel CMOS image sensors. Our highly integrated image sensors are designed to be cost effective and to provide brighter, sharper and more colorful image quality for use primarily in applications that require small form factors, low power consumption, effective heat dissipation and high reliability.

*Semiconductor Manufacturing Services:* Our Semiconductor Manufacturing Services segment uses our process technology and manufacturing facilities to manufacture semiconductor wafers for third parties based on their designs. We provide our services to specialty markets that utilize high-voltage, embedded memory, analog and power processes. We offer customized services for clients globally at our state-of-the-art fabrication facilities located in Cheongju and Gumi, Korea. Our fabs provide us with large scale, cost-effective and flexible capacity enabling us to rapidly scale to high volume to meet shifts in demand by our end customers.

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### **Basis of Presentation**

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. The consolidated statements of operations include allocations of certain raw materials, other assets and accounts payable which our business has historically shared with Hynix, and allocations of certain manufacturing costs, general and administrative, sales and marketing, and other miscellaneous expenses. These allocations were made on a specifically identifiable basis or using the relative percentages, as compared to Hynix's other businesses, of sales, headcount, raw material consumption or other reasonable methods. Hynix and MagnaChip considered these allocations to be a reasonable reflection of the utilization of services provided. We believe the assumptions underlying the consolidated financial statements are reasonable. However, the consolidated financial statements may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been, had we been a separate stand-alone company during the historical carve-out periods presented. As part of the Original Acquisition, we did not acquire certain assets that were included in the carve-out financial statements and we assumed certain additional obligations that are not reflected in the carve-out financial statements. Accordingly, the carve-out financial statements should not be relied upon as being representative of our financial position or operating results had we operated on a stand alone basis, nor may they be representative of our financial position or operating results following the Original Acquisition.

Prior to our fiscal year 2006, we operated in a single segment semiconductor manufacturing. In our fiscal year 2006, subsequent to the appointment of 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 Related Information*, the manner in which the CODM reviewed the Company's operational results and made significant business decisions was changed to include disaggregated financial information with respect to our three primary business units. Segment information for the prior periods was prepared in conformity with the current segment structure.

**Table of Contents****Results of Operations Comparison of Years Ended December 31, 2006 and December 31, 2005**

	Year ended December 31,		Year ended December 31,		Change	
	2006	% of net sales	2005	% of net sales	Amount	%
	<i>(in millions of US dollars; %)</i>					
Net sales	\$ 744.3	100.0	\$ 937.7	100.0	\$ (193.4)	(20.6)
Cost of sales	644.9	86.6	729.0	77.7	(84.1)	(11.5)
Gross profit	99.4	13.4	208.7	22.3	(109.3)	(52.4)
Selling, general and administrative expenses	87.7	11.8	123.3	13.1	(35.6)	(28.9)
Research and development expenses	131.2	17.6	107.6	11.5	23.6	21.9
Restructuring and impairment charges	94.3	12.7	36.2	3.9	58.1	160.5
Operating income (loss)	(213.8)	(28.7)	(58.4)	(6.2)	(155.4)	266.1
Interest expense, net	(57.2)	(7.7)	(57.2)	(6.1)	0.0	0.0
Foreign currency gain, net	50.9	6.8	16.5	1.8	34.4	208.5
Income (loss) before income taxes	(220.1)	(29.6)	(99.1)	(10.5)	(121.0)	122.1
Income tax expenses	9.2	1.2	1.8	0.2	7.4	411.1
Net income (loss)	\$ (229.3)	(30.8)	\$ (100.9)	(10.7)	\$ (128.4)	127.3

**Net Sales**

	Year ended December 31,		Year ended December 31,		Change	
	2006	% of total	2005	% of total	Amount	%
	<i>(in millions of US dollars; %)</i>					
Display solutions	\$ 273.7	36.8	\$ 326.1	34.8	\$ (52.4)	(16.1)
Imaging solutions	60.5	8.1	163.3	17.4	(102.8)	(63.0)
Semiconductor Manufacturing Services	342.4	46.0	345.4	36.8	(3.0)	(0.9)
All other	67.7	9.1	102.9	11.0	(35.2)	(34.2)
	\$ 744.3	100.0	\$ 937.7	100.0	\$ (193.4)	(20.6)

We derive a majority of our net sales from three operating segments: Display Solutions, Imaging Solutions and Semiconductor Manufacturing Services. The All other category for 2006 represents certain business activities other than these business segments, principally composed of rental and unit processing. All other for the prior period also included certain business activities exited in late 2005 or early 2006, such as our application processor and DRAM foundry business.

Total net sales for 2006 decreased \$193.4 million, or 20.6% compared to 2005. Net sales generated from the three operating 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.

*Display Solutions.* Net sales from Display Solutions for the year ended December 31, 2006 were \$273.7 million, a \$52.4 million or 16.1% decrease from \$326.1 million for the year ended December 31, 2005. This decrease was primarily attributable to sales volume decrease in large

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display driver products as a result of our customer's inventory correction, build-up of inventory in the prior year and subsequent reductions of inventory in 2006 due to less-than-expected market demand from our major customers. In addition, average selling price erosion during 2006 also had a negative impact on net sales.

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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 missed opportunities from our delays in transition to new mega-pixel products, which was expected to substitute our VGA products. Revenue from our traditional VGA products decreased year-over-year due to lower market demand and a decline in average selling price.

**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. A moderate decrease in average selling price was mostly offset by an increase in wafer volume.

**All other.** Net sales from All other for 2006 were \$67.7 million compared to \$102.9 million for 2005. The year-over-year reduction of \$35.2 million represents net sales from the exited application processor business and DRAM foundry business, which was partially offset by an increase in revenue from unit processing.

**Gross Profit**

	Year ended December 31,		Year ended December 31,		Change	
	2006		2005			
	Amount	% of net sales	Amount	% of net sales	Amount	%
<i>(in millions of US dollars; %)</i>						
Display solutions	\$ 35.6	13.0	\$ 66.6	20.4	\$ (31.0)	(46.5)
Imaging solutions	(4.0)	(6.6)	25.4	15.6	(29.4)	(115.7)
Semiconductor Manufacturing Services	45.7	13.3	110.4	32.0	(64.7)	(58.6)
All other	22.1	32.6	6.3	6.1	15.8	250.8
	\$ 99.4	13.4	\$ 208.7	22.3	\$ (109.3)	(52.4)

Total gross profit decreased \$109.3 million in 2006, or 52.4%, compared to gross profit generated in 2005. Gross margin percentage for 2006 was 13.4% of net sales, a decrease of 8.9% from 22.3% for 2005. This decline in gross margin percentage was primarily attributable to lower utilization of our manufacturing capacity as a result of substantial sales decreases, coupled with an overall decrease in average selling prices.

**Display Solutions.** Gross margin percentage for Display Solutions for the year ended December 31, 2006 declined to 13.0% compared to 20.4% for the year ended December 31, 2005. This decline in gross margin percentage was primarily attributable to lower average selling price and higher overhead cost per-unit driven by a decrease in unit volume.

**Imaging Solutions.** Imaging Solutions reported gross loss for the year ended December 31, 2006, due to a significant reduction in revenues as a result of a weak market position for new products, coupled with significant decreases in market demand for existing products.

**Semiconductor Manufacturing Services.** Gross margin for Semiconductor Manufacturing Services declined to 13.3% in 2006 from 32.0% in 2005. The year-over-year decrease was primarily attributable to lower margin mix within the segment.

**All other.** Gross margin percentage for All other for 2006 increased to 32.6% from 6.1% for the year ended December 31, 2005. This increase is 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 \$123.3 million or 13.1% for the year ended December 31, 2005. This decrease of \$35.6 million or 28.9% from the prior year was primarily



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attributable to a reduction in professional service fees driven by our cost containment efforts and a 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 \$131.2 million, a \$23.6 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 represents our focus on the introduction of new products, especially in the Imaging Solutions and Display Solutions segments. As a percentage of net sales, research and development expense increased to 17.6% in current period 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, *Accounting for the Impairment or Disposal of Long-lived Assets* and \$1.4 million of restructuring charges under SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*.

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 of the Fab 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 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 the 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 for 2006 were incurred in connection with the termination of certain of our management and employees.

During the year ended December 31, 2005, the Company 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)***

*Net Interest Expense.* 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. Substantially all of our interest expense is to serve our long-term borrowings of \$750.0 million at a weighted-average interest rate of 7.4%.

*Net Foreign Currency Gain.* 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.

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

Income tax expenses for the year ended December 31, 2006 were \$9.2 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 change in business model. Income tax expense for 2006 was 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.



**Table of Contents****Results of Operations Comparison of Years Ended December 31, 2005 and December 31, 2004**

	Year ended December 31, 2004							
	Year ended December 31, 2005		Three months ended December 31, 2004		Nine months ended September 30, 2004		Total twelve months ended December 31, 2004	
	Amount	% of net sales	Amount	Amount	Amount	Amount	% of net sales	Change
							Amount	%
	(Successor Company)		2004		(Predecessor Company)		2004	
	<i>(in millions of US dollars; %)</i>							
Net sales								
Related party	\$		\$	\$	\$	\$	\$	\$
Others	937.7	100.0	243.6	677.8	921.4	84.9	16.3	1.8
	937.7	100.0	243.6	841.6	1,085.2	100.0	(147.5)	(13.6)
Cost of sales	729.0	77.7	204.5	654.6	859.1	79.2	(130.1)	(15.1)
Gross profit	208.7	22.3	39.1	187.0	226.1	20.8	(17.4)	(7.7)
Selling, general and administrative expenses	123.3	13.1	29.8	54.0	83.8	7.7	39.5	47.1
Research and development expenses	107.6	11.5	22.1	75.7	97.8	9.0	9.8	10.0
Restructuring and impairment charges	36.2	3.9					36.2	n/a
Operating income (loss)	(58.4)	(6.2)	(12.8)	57.3	44.5	4.1	(102.9)	(231.2)
Interest expense, net	(57.2)	(6.1)	(16.7)	(17.7)	(34.4)	(3.2)	(22.8)	66.3
Foreign currency gain, net	16.5	1.8	30.4	5.3	35.7	3.3	(19.2)	(53.8)
Others, net				1.1	1.1	0.1	(1.1)	n/a
Income (loss) before income taxes	(99.1)	(10.5)	0.9	46.0	46.9	4.3	(146.0)	(311.3)
Income tax expenses	1.8	0.2	6.7	2.8	9.5	0.9	(7.7)	(81.1)
Net income (loss)	\$ (100.9)	(10.7)	\$ (5.8)	\$ 43.2	\$ 37.4	3.4	\$ (138.3)	(369.8)

**Net Sales**

	Year ended December 31, 2004							
	Year ended December 31, 2005		Three months ended December 31, 2004		Nine months ended September 30, 2004		Total twelve months ended December 31, 2004	
	Amount	% of total	Amount	Amount	Amount	Amount	% of total	Change
							Amount	%
	(Successor Company)		2004		(Predecessor Company)		2004	
	<i>(in millions of US dollars; %)</i>							

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Display solutions	\$ 326.1	34.8	\$ 60.3	\$	198.8	\$ 259.1	23.9	67.0	25.9
Imaging solutions	163.3	17.4	58.1		142.1	200.2	18.5	(36.9)	(18.4)
Semiconductor Manufacturing Services	345.4	36.8	88.3		270.2	358.5	33.0	(13.1)	(3.7)
All other	102.9	11.0	36.9		230.5	267.4	24.6	(164.5)	(61.5)
	\$ 937.7	100.0	\$ 243.6	\$	841.6	\$ 1,085.2	100.0	(147.5)	(13.6)

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Total net sales for the year ended December 31, 2005 were \$937.7 million, a \$147.5 million or 13.6% decrease from \$1.1 billion in 2004, which consisted of \$841.6 million for the nine months ended September 30, 2004 and \$243.6 million for the three months ended December 31, 2004. The reduction was primarily attributable to a decrease of \$133.4 million in our DRAM foundry business with Hynix, which is included in the All other category, driven by our strategic decision to focus on three core segments. Net sales generated from the three operating segments in 2005 were \$834.8 million, compared to \$817.8 million in 2004.

*Display Solutions.* Net sales from Display Solutions for the year ended December 31, 2005 were \$326.1 million, a \$67.0 million or 25.9% increase from \$259.1 million for the year ended December 31, 2004. This revenue increase for Display Solutions was driven by an expansion in market demand, partially offset by a slight decline in average selling prices.

*Imaging Solutions.* Imaging Solutions net sales for the year ended December 2005 were \$163.3 million, a decrease of \$36.9 million or 18.5%, compared to \$200.2 million for the year ended December 31, 2004. This decrease in net sales was mainly attributable to a decline in average selling price, especially in VGA products, which was partially offset by an increase in unit volume sales.

*Semiconductor Manufacturing Services.* Net sales for the year ended December 31, 2005 generated from Semiconductor Manufacturing Services were \$345.4 million, relatively consistent compared to \$358.5 million of revenue for the year ended December 31, 2004 as a decrease in sales volume was mostly offset by an increase in average selling price.

*All other.* Net sales from All other decreased 61.5% to \$102.9 million in 2005 from \$267.4 million in 2004 as we strategically reduced DRAM foundry and application solutions in an effort to focus on three major business segments.

**Gross Profit**

	Year ended December 31, 2004							
	Year ended December 31, 2005		December 31, 2004		Three months ended September 30, 2004		Total twelve months ended December 31, 2004	
	Amount	% of net sales	Amount	% of net sales	Amount	% of net sales	Amount	% of net sales
	(Successor Company)		(Predecessor Company)		(Predecessor Company)		(Predecessor Company)	
	<i>(in millions of US dollars; %)</i>							
Display solutions	\$ 66.6	20.4	\$ 4.5	\$ 30.3	\$ 34.8	13.4	\$ 31.8	91.4
Imaging solutions	25.4	15.6	12.7	56.7	69.4	34.7	(44.0)	(63.4)
Semiconductor Manufacturing Services	110.4	32.0	19.1	86.3	105.4	29.4	5.0	4.7
All other	6.3	6.1	2.8	13.7	16.5	6.2	(10.2)	(61.8)
	\$ 208.7	22.3	\$ 39.1	\$ 187.0	\$ 226.1	20.8	\$ (17.4)	(7.7)

Total gross profit for 2005 decreased \$17.4 million or 7.7%, compared to gross profit generated in 2004 mainly due to a decrease in revenue base. Gross margin percentage for 2005 increased to 22.3% of net sales from 20.8% of net sales for 2004. This improvement in gross margin percentage was primarily attributable to lower depreciation costs for 2005 associated with the application of purchase accounting from the Original Acquisition.

*Display Solutions.* Gross margin percentage for Display Solutions for the year ended December 31, 2005 increased to 20.4% as compared to 13.4% for the year ended December 31, 2004. The increase in gross margin percentage was primarily attributable to lower per-unit overhead costs driven by a significant increase in unit volume produced during 2005.



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*Imaging Solutions.* Gross margin percentage for Imaging Solutions for 2005 was 15.6% compared with 34.7% for 2004. The gross margin decrease from 2004 was primarily attributable to decrease in average selling prices.

*Semiconductor Manufacturing Services.* Gross margin for Semiconductor Manufacturing Services increased to 32.0% in 2005 from 29.4% in 2004. This increase in gross margin percentage in 2005 resulted from higher average selling price and lower depreciation expenses during the period.

*All other.* Gross margin percentage for All other for 2005 was 6.1%, relatively consistent with 6.2% for 2004.

### ***Operating Expenses***

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$123.3 million or 13.1% of net sales in 2005. This represents a \$39.5 million or 47.1% increase from a total of \$83.8 million or 7.7% of net sales in 2004, which consisted of \$54.0 million for the nine months ended September 30, 2004 and \$29.8 million for the three months ended December 31, 2004. The increase in selling, general and administrative expenses was primarily attributable to amortization of intangible assets recorded upon the application of purchase accounting as a result of the Original Acquisition. We also recognized increased professional fees related to consulting and infrastructure build-out as well as additional warranty reserves to cover possible exposures to future claims from customers.

*Research and Development Expenses.* Research and development expenses in 2005 were \$107.6 million, a \$9.8 million or 10.0% increase from \$97.8 million in 2004, which consisted of \$75.7 million for the nine months ended September 30, 2004 and \$22.1 million for the three months ended December 31, 2004. The increase in research and development expenses was mainly due to our reinforcement of research and development centers worldwide through our mergers and acquisitions and process development to support next generation products. As a percentage of net sales, research and development expense increased to 11.5% in 2005 from 9.0% in 2004.

*Restructuring and Impairment Charges.* During the year ended December 31, 2005, the Company recorded a one-time charge of \$36.2 million of restructuring and impairment charges associated with the Company's initiative to focus on its core businesses and streamline the organization. The amount included \$33.5 million for asset impairment and \$2.7 million for restructuring.

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

*Net Interest Expense.* Net interest expense was \$57.2 million in 2005, a \$22.8 million or 66.3% increase from aggregated interest expense of \$34.4 million in 2004, which consisted of \$17.7 million for the nine months ended September 30, 2004 and \$16.7 million for the three months ended December 31, 2004. The increase in net interest expense was primarily due to interest expenses incurred on the long-term debt of \$750.0 million, which was issued in December 2004 and outstanding throughout the year 2005.

*Net Foreign Currency Gain.* Net foreign currency gain for the year ended December 31, 2005 was \$16.5 million, compared to \$35.7 for the year ended December 31, 2004. A substantial portion of our net foreign currency gain for 2005 was non-cash translation gain recorded for intercompany borrowings at one of our subsidiaries.

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

*Income Tax Expense.* Income tax expense was \$1.8 million in 2005, compared to \$6.7 million for the three months ended December 31, 2004 and \$2.8 million for the nine months ended September 30, 2004, which on an aggregate basis totaled \$9.5 million for the year ended December 31, 2004. Income tax expense for the year ended December 31, 2005 was primarily attributable to \$5.2 million of Korean withholding tax on the interest

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income paid to our Korean subsidiary's parent company. Income tax expense including this withholding tax was partially offset by the recognition of a deferred tax asset at our Japanese subsidiaries based on temporary difference related to revenue recognition.

### **Liquidity and Capital Resources**

Our principal capital requirements are to fund working capital needs, to meet required debt payments, including debt service payments on the notes and, if drawn upon, the senior credit facility, and to invest in research and development and capital equipment. We anticipate that operating cash flow, together with available borrowing capacity under our senior credit facility, will be sufficient to meet our working capital needs, our research and development and capital expenditures needs and service requirements on our debt obligations for the foreseeable future. As of December 31, 2006 we had total long-term debt outstanding of \$750.0 million.

Our principle sources of liquidity are our cash, cash equivalents and available borrowings under our senior credit facility of \$100 million. As of December 31, 2006 our cash and cash equivalents balance was \$89.2 million or 11.6% of our total assets, a \$2.6 million increase from \$86.6 million or 8.3% of total assets as of December 31, 2005. The increase in cash and cash equivalents was due to cash inflow from operating activities coupled with an increase from foreign currency translation gains, mostly offset by cash outflows for capital expenditures and other investing activities.

We generated cash from operating activities of \$30.5 million during the year 2006, which principally reflects the Company's net loss of \$229.3 million adjusted by \$247.2 million of total non-cash items composed mainly of depreciation and amortization expenses and impairment charges. Cash from operating activities for 2006 decreased \$73.1 million from \$103.6 million for 2005. This decrease in cash from operating activities between the two periods was primarily due to 52.4% lower gross profits mitigated by a decrease in working capital during the year 2006.

Our working capital balance as of December 31, 2006 was \$122.6 million compared to \$141.4 million as of December 31, 2005. The decrease of \$18.8 million in our working capital balance consisted primarily of a \$35.4 million decrease in accounts receivable and \$30.8 million decrease in inventories, partially offset by a \$34.5 million decrease in accounts and other accounts payable and \$5.3 million decrease in accrued expenses. This decrease in working capital is mainly attributable to a 20.6% decline in total net sales.

For investing activities, we used cash of approximately \$33.4 million in 2006 compared to \$64.1 million in 2005. The decrease in cash used for investing activities during the year 2006 was primarily attributable to lower capital equipment expenditures during the year. Cash outflows for acquisitions of subsidiaries in 2005 in an effort to reinforce global R&D capability also led to a higher investing cash outlay in 2005. We did not consummate any business acquisitions during the year 2006. Capital expenditures for the year ended December 31, 2006 were \$41.4 million, a decrease of \$23.1 million or 35.8% compared to \$64.5 million for the year ended December 31, 2005. This year over year decrease was a result of managing capital expenditure timing in order to better support the growth of our business from new customers and to optimize returns on investment.

For financing activities, we used \$0.3 million for the year ended December 31, 2006, compared to \$12.8 million for the year ended December 31, 2005. As we had sufficient capital resources available to serve our capital requirements we did not have significant financing activities during the year 2006. The cash outlay in 2006 was mainly due to our repurchase of common units upon termination of certain of our management and employees. Cash outflow in 2005 was mainly for the repayment of short-term borrowings at one of our subsidiaries that we acquired during the year.

*Future Financing Activities.* Our primary future capital requirements on a recurring basis will be funding working capital needs, meeting required debt payments, funding research and development, and capital expenditures. We anticipate that operating cash flows, together with available borrowings under our senior credit

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facility, will be sufficient to meet these capital requirements for the foreseeable future. We may from time to time incur additional debt.

We may need to incur additional debt or issue equity to make strategic acquisitions of investments. However, we cannot assure you that such financing will be available to us on acceptable terms or that such financing will be available at all.

**Contractual Obligations**

Summarized in the table below are our obligations and commitments to make future payments under debt obligations and minimum lease payment obligations as of December 31, 2006.

	Payments Due by Period						Interest expense
	Total	2007	2008	2009	2010	2011	
	<i>(in millions of US dollars)</i>						
Revolving credit facility							
Secured notes and subordinated notes(*)	750.0					500.0	250.0
Operating lease	59.5	11.9	11.9	11.9	11.9	11.9	
Others	8.5	7.7	1.1				(0.3)

(\*) Excludes interest obligations on revolving credit facility and notes.

The Floating Rate Second Priority Senior Secured Notes of \$300 million and Second Priority Senior Secured Notes of \$200 million mature in 2011, while the Senior Subordinated Notes of \$250 million mature in 2014. Interest rates are 3 month LIBOR + 3.25%, 6<sup>7</sup>/<sub>8</sub>% and 8%, respectively. These notes will be paid in full upon maturity.

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

**Off-Balance Sheet Arrangements**

On December 23, 2004, two of the Company's subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company entered into a senior credit agreement with a syndicate of banks, financial institutions and other entities providing for a \$100 million senior secured revolving credit facility. The undrawn portion of such senior secured credit line as of December 31, 2006 and December 31, 2005 were \$93.8 million and \$83 million, respectively. The utilized portions of the credit line are related to the issuance of letters of credit rather than cash drawdowns.

Other than the senior credit facility, there are no material off-balance sheet arrangements that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources that is material to investors.

**Recent Accounting Pronouncements**

In September 2006, FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plan* an amendment of SFAS No. 87, 88, 106 and 132(R). This Statement requires an employer to recognize the over funded or under funded status of a defined benefit post retirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position, and to recognize changes in that funded status in the year in which the changes occur through comprehensive income. SFAS No. 158 is effective for fiscal years ending after June 15, 2007.

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We do not expect that the implementation of SFAS No. 158 will have a material impact on our financial position and results of operations.

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.

In September 2006, the SEC issued SAB No. 108 which provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The guidance is applicable for fiscal years ending after November 15, 2006. We do not expect that adoption of SAB 108 will have a material impact on our consolidated financial statements.

In June 2006, the FASB issued FIN No. 48, *Accounting for Uncertainty in Income Taxes* an interpretation of SFAS No. 109. FIN 48 clarifies the accounting for uncertain income tax positions accounted for in accordance with SFAS No. 109. The Interpretation stipulates recognition and measurement criteria in addition to classification, interim period accounting and significantly expanded disclosure provisions for uncertain tax positions that are expected to be taken in a company's tax return. FIN 48 is effective for fiscal years beginning after December 15, 2006. We are currently evaluating the impact that the adoption may have on our consolidated financial statements.

In March 2006, the FASB issued SFAS No. 156, *Accounting for Servicing of Financial Assets* an amendment of FASB Statement No. 140. This Statement addresses the accounting for recognized servicing assets and liabilities related to certain transfers of the servicer's financial assets and for acquisitions or assumptions of obligations to service financial assets that do not relate to the financial assets of the servicer and its related parties. SFAS No. 156 requires that all recognized servicing assets and liabilities are initially measured at fair value, and subsequently measured at either fair value or by applying an amortization method for each class of recognized servicing assets and liabilities. SFAS No. 156 is effective in fiscal years beginning after September 15, 2006. The adoption of SFAS No. 156 is not expected to have a material impact on our consolidated financial statements.

In February 2006, the FASB issued SFAS No. 155, *Accounting for Certain Hybrid Financial Instruments* an amendment of FASB Statements No. 133 and 140. This Statement amends SFAS No. 133 and SFAS No. 140, and improves the financial reporting of certain hybrid financial instruments by requiring more consistent accounting. Specifically, this Statement allows fair value re-measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. This Statement is effective for all financial instruments acquired or issued after the beginning of an entity's first fiscal year that begins after September 15, 2006. The adoption of this Statement is not expected to have a material impact on our consolidated financial statements.

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

The preparation of financial statements and related disclosures in conformity with U.S. GAAP requires our management to make significant judgments and estimates that affect our financial position and results of operations. For a summary of our significant accounting policies, including the accounting policies discussed below, see Note 2 to the Consolidated Financial Statements.

#### ***Revenue Recognition***

Our revenue is derived from the sale of semiconductor products we design and the manufacture of semiconductor wafers for third parties. We recognize revenue when persuasive evidence of an arrangement



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exists, the product has been delivered and title and risk of loss have transferred, the price is fixed and determinable, and collection of resulting receivables is reasonably assured. For certain distributors, standard products are sold without rights to return products or stock rotation or price protection rights. Our policy is to recognize revenue upon delivery of products to customers, where shipment represents the point when the rights and risks of ownership have passed to the customer, when persuasive evidence of an arrangement exists, the product has been delivered, the price is fixed or determinable and collection of the resulting receivable is reasonably assured. Specialty foundry services are performed pursuant to manufacturing agreements and purchase orders. Standard products are shipped and sold based upon purchase orders from customers. All amounts billed to a customer related to shipping and handling are classified as sales, while all costs incurred by us for shipping and handling are classified as expenses.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make payment. If the financial condition of our customers were to deteriorate, additional allowances may be required. We record warranty liabilities for the estimated costs that may be incurred under our limited warranty. This warranty covers product defects based on compliance to our specifications and is normally applicable for twelve months from the date of purchase. These liabilities are recorded when related revenue is recognized. Warranty costs include the costs to replace the defective product. Factors that affect our warranty liability include the historical and anticipated rate of warranty claims on those repairs and the cost per claim to satisfy our warranty obligations. As these factors are impacted by actual experience and future expectations, we periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary.

### ***Inventory Valuation***

Inventories are stated at the lower of cost or market, using the average cost method, which approximates the first in, first out method. If net realizable value is less than cost at the balance sheet date, the carrying amount is reduced to the realizable value, and the difference is recognized as a loss on valuation of inventories under cost of sales. We estimate the net realizable value for such finished goods and work-in-progress based on current invoice prices. Inventory reserves are established when conditions indicate that the net realizable value is less than cost due to physical deterioration, obsolescence, changes in price levels, or other causes. Reserves are also established for excess inventory based on inventory levels in excess of six months of projected demand, as judged by management, for each specific product.

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

### ***Useful Lives of Tangible and Intangible Assets***

Property, plant and equipment are stated at cost, less accumulated depreciation. Depreciation is computed using the straight-line method over the estimated useful lives of the assets. Buildings and related structures are depreciated over the 10 to 40 year periods. Machinery, equipment and other assets including vehicles are depreciated over the estimated useful lives ranging 5 to 10 years.

Upon the Original Acquisition, machinery, equipment and other assets were assumed from Hynix, approximately 50% depreciated. Accordingly, remaining useful lives of these assets were determined at approximately 50% of initial useful lives.

Our intangible assets represent rights under patents, trademarks, property use rights, customer relationship and technology, and are amortized over the periods of benefit, ranging up to 10 years, on a straight-line basis.

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

We review the carrying value of fixed assets for impairment when events and circumstances indicate that the carrying value of an asset or group of assets may not be recoverable from the estimated future cash flows expected to result from its use and/or disposition. Factors which could trigger an impairment review include the following: (i) significant negative industry or economic trends, (ii) exiting an activity in conjunction with a restructuring of operations, (iii) current, historical or projected losses that demonstrate continuing losses associated with an asset, and (iv) management's assessment of future manufacturing capacity requirements. In cases where undiscounted expected future cash flows are less than the carrying value, an impairment charge is recognized equal to the amount by which the carrying value exceeds the estimated fair value of the assets. The estimation of future cash flows involves numerous assumptions, which require our judgment, including, but not limited to, future use of the assets for our operations versus sale or disposal of the assets, future-selling prices for our products and future production and sales volumes. In addition, we must use our judgment in determining the groups of assets for which impairment tests are separately performed.

### ***Restructuring Charges***

We recognize 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.

### ***Income taxes***

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in a company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

We established valuation allowances for deferred tax assets at most of our subsidiaries since, other than with respect to one particular subsidiary, it is not probable that a majority of the deferred tax assets will be realizable. The valuation allowance at this particular subsidiary was not set up since it is expected that the deferred tax assets at this subsidiary will be deemed realizable based on the current prospects for its future taxable income.

### ***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 provision 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 prior-period pro forma presentation under SFAS No. 123, we use the Black-Scholes option pricing model to value options. In developing assumptions for fair value calculation under SFAS No. 123(R), we use estimates based on historical data and market information. A small change in the assumptions used in the estimate can cause a relatively significant change in the fair value calculation.

The valuation of our common unit is based on an independent appraisal from a third party and is updated reflecting the changes in our financial results and prospects. Determination of the fair value of our common units involves complex and subjective judgments. If we make different judgments or adopt different assumptions, material differences could result in the timing and amount of the unit-based compensation expenses recorded because the estimated fair value of the underlying units for the options granted would be different.

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### ***Segment Information***

We have determined, based on the nature of our operations and products offered to customers, that our reportable segments are Display Solutions, Imaging Solutions, and Semiconductor Manufacturing Services. Our chief operating decision maker ( CODM ) as defined by SFAS 131, *Disclosure about Segments of an Enterprise and Related Information*, allocates resources to and assesses the performance by these segments. Prior to 2006, we had a single reportable segment semiconductor manufacturing.

### **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.

*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, 2006 for our Korean subsidiary, a 10% devaluation of the Korean Won against the U.S. dollar would have resulted in a decrease of \$3.2 million in our U.S. dollar financial instruments balance and 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, 2006, we estimate that we would have additional interest expense costs over the market rate of \$2.8 million (360 days basis). The fair value of these fixed rate notes would have decreased by \$8.6 million or increased by \$8.9 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. With this interest rate swap, cash flow interest rate risk was replaced with exposure to interest rate risk. For details, refer to Note 9. Long-term Borrowings.

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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 (Successor Company)

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, 2006 and 2005, and the results of their operations and their cash flows for the years ended December 31, 2006 and 2005 and for the three-month period ended December 31, 2004 (successor basis), 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

March 26, 2007

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**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Unitholders of

MagnaChip Semiconductor LLC (Predecessor Company)

In our opinion, the accompanying consolidated (carve-out) statements of operations, of changes in owners' equity and of cash flows present fairly, in all material respects, the results of operations and cash flows of MagnaChip Semiconductor LLC and its subsidiaries (Predecessor Company) (the Company) for the nine-month period ended September 30, 2004 (predecessor basis), 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

June 15, 2005

**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Consolidated Statements of Operations****(In thousands of US dollars, except unit data)**

	Year Ended		Three months ended December 31, 2004	Nine months ended September 30, 2004 (Predecessor Company)
	December 31, 2006	December 31, 2005 (Successor Company)		
Net sales				
Related party	\$	\$	\$	\$ 163,760
Other	744,352	937,656	243,582	677,828
	744,352	937,656	243,582	841,588
Cost of sales	644,911	728,999	204,461	654,569
Gross profit	99,441	208,657	39,121	187,019
Selling, general and administrative expenses	87,677	123,211	29,784	53,982
Research and development expenses	131,252	107,590	22,058	75,657
Restructuring and impairment charges	94,266	36,234		
Operating income (loss)	(213,754)	(58,378)	(12,721)	57,380
Other income (expenses)				
Interest expense, net	(57,159)	(57,236)	(16,816)	(17,749)
Foreign currency gain, net	50,861	16,532	30,437	5,364
Other				1,070
	(6,298)	(40,704)	13,621	(11,315)
Income (loss) before income taxes	(220,052)	(99,082)	900	46,065
Income tax expenses	9,258	1,816	6,725	2,828
Net income (loss)	\$ (229,310)	\$ (100,898)	\$ (5,825)	\$ 43,237
Dividends accrued on preferred units	10,912	9,928	13,428	
Net loss attributable to common units	\$ (240,222)	\$ (110,826)	\$ (19,253)	
Net loss per common unit Basic and diluted	\$ (4.54)	\$ (2.10)	\$ (0.38)	
Weighted average number of units Basic and diluted	52,911,734	52,898,497	50,061,910	

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





**Table of Contents****MagnaChip Semiconductor LLC and Subsidiaries****Consolidated Balance Sheets**

(In thousands of US dollars, except unit data)

	December 31, 2006	December 31, 2005
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 89,173	\$ 86,574
Restricted cash		2,837
Accounts receivable, net	76,665	112,053
Inventories, net	57,846	88,677
Other receivables	6,754	9,501
Other current assets	13,626	10,148
<b>Total current assets</b>	<b>244,064</b>	<b>309,790</b>
Property, plant and equipment, net	336,279	485,077
Intangible assets, net	139,729	191,389
Other non-current assets	49,981	54,391
<b>Total assets</b>	<b>\$ 770,053</b>	<b>\$ 1,040,647</b>
<b>Liabilities and Unitholders Equity</b>		
Current liabilities		
Accounts payable	\$ 62,399	\$ 93,911
Other accounts payable	32,423	35,368
Accrued expenses	23,647	28,968
Other current liabilities	2,980	10,102
<b>Total current liabilities</b>	<b>121,449</b>	<b>168,349</b>
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	62,836	55,124
Other non-current liabilities	2,935	7,196
<b>Total liabilities</b>	<b>937,220</b>	<b>980,669</b>
Commitments and contingencies		
Series A redeemable convertible preferred units; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at December 31, 2006 and 2005		
Series B redeemable convertible preferred units; 550,000 units authorized, 450,692 units issued and 93,997 units outstanding at December 31, 2006 and 2005	117,374	106,462
<b>Total redeemable convertible preferred units</b>	<b>117,374</b>	<b>106,462</b>
Unitholders equity		
Common units; 65,000,000 units authorized, 52,720,784 and 53,091,570 units issued and outstanding at December 31, 2006 and 2005, respectively	52,721	53,092
Additional paid-in capital	2,451	2,169
Accumulated deficit	(370,314)	(130,092)

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Accumulated other comprehensive income	30,601	28,347
Total unitholders' equity	(284,541)	(46,484)
Total liabilities, redeemable convertible preferred units and unitholders' equity	\$ 770,053	\$ 1,040,647

*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 and Owners' Equity**

(In thousands of US dollars, except unit data)

	Common Units			Owner Equity	Deferred Stock Compensation	Accumulated deficit	Accumulated Other Comprehensive Income (loss)	Total
	Units	Amount	Additional Paid-In Capital					
<b>(Predecessor Company)</b>								
<b>Balance at January 1, 2004</b>				\$ 135,781	\$ 2,350		\$ 17,183	\$ 155,314
Comprehensive income :								
Net income				43,237				43,237
Foreign currency translation adjustments							4,842	4,842
Total comprehensive income								48,079
Deferred stock compensation					3,324			3,324
<b>Balance at September 30, 2004</b>				\$ 179,018	\$ 5,674		\$ 22,025	\$ 206,717
<b>(Successor Company)</b>								
<b>Balance at October 1, 2004</b>	49,713,286	\$ 49,713	\$			\$ (13)	\$ (116)	\$ 49,584
Issuance of common units	363,627	364						364
Exercise of unit options	2,456,090	2,456						2,456
Issuance of warrants in connection with Original Acquisition			2,100					2,100
Payment of accumulated accrued dividends						(10,891)		(10,891)
Dividends accrued on preferred units						(2,537)		(2,537)
Comprehensive income (loss):								
Net loss						(5,825)		(5,825)
Foreign currency translation adjustments							20,621	20,621
Total comprehensive income								14,796
<b>Balance at December 31, 2004</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 loss						(100,898)		(100,898)
Fair valuation of derivatives							4,534	4,534
Foreign currency translation adjustments							3,308	3,308
Total comprehensive loss								(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 loss						(229,310)		(229,310)
Fair valuation of derivatives							(193)	(193)
Foreign currency translation adjustments							2,447	2,447

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Total comprehensive loss (227,056)

<b>Balance at December 31, 2006</b>	52,720,784	\$ 52,721	\$ 2,451	\$ (370,314)	\$ 30,601	\$ (284,541)
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*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)**

	Year Ended December 31		Three months ended December 31,	Nine months ended September 30,
	2006	2005 (Successor Company)	2004	2004 (Predecessor Company)
<b>Cash flows from operating activities</b>				
Net income (loss)	\$ (229,310)	\$ (100,898)	\$ (5,825)	\$ 43,237
Adjustments to reconcile net income (loss) to net cash provided by operating activities				
Depreciation and amortization	188,560	202,929	45,855	266,862
Provision for severance benefits	11,497	16,583	3,397	15,353
Amortization of debt issuance costs	3,701	3,432	4,411	
Gain on foreign currency translation, net	(54,188)	(15,880)	(33,263)	(3,811)
Loss (gain) on disposal of property, plant and equipment, net	1,490	(829)	(193)	(488)
Impairment charges	92,858	33,576		
Unit/stock-based compensation	243			3,324
Other	3,023	721	494	3,138
Changes in operating assets and liabilities				
Accounts receivable	44,091	(25,812)	(43,270)	(7,067)
Inventories	37,064	(806)	36,513	(18,070)
Other receivables	3,180	62,821	(56,917)	(548)
Deferred tax assets	1,954	(12,935)		
Accounts payable	(38,423)	24,928	(33,061)	(5,719)
Other accounts payable	(15,897)	(66,069)	81,509	18,329
Accrued expenses	(7,453)	(5,184)	17,711	584
Other current assets	5,063	2,713	(6,009)	(1,177)
Other current liabilities	(7,329)	200	9,842	1,450