MAGNACHIP SEMICONDUCTOR LLC
Form 10-Q
November 14, 2006
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark one)

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

MAGNACHIP SEMICONDUCTOR LLC

(Exact name of Registrant as specified in its charter)

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

Luxembourg, Grand Duchy of Luxembourg
(Address of principal executive offices) **(Zip Code)**
Registrant s telephone number, including area code: (352) 45-62-62

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

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

Large accelerated filer ¨ Accelerated filer ¨ Non-accelerated filer x

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 ofthe Exchange

Act). Yes ¨ No x

As of November 1, 2006, the registrant had 52,720,784.0470 of the registrant s common units outstanding.

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MagnaChip Semiconductor LLC and Subsidiaries

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

MagnaChip Semiconductor LLC and Subsidiaries

Condensed Consolidated Statements of Operations

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

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Net sales	$ 171,283	$ 243,089	$ 582,039	$ 692,502
Cost of sales	150,422	181,177	500,579	544,234
Gross profit	20,861	61,912	81,460	148,268
Selling, general and administrative expenses	22,812	28,166	66,368	89,163
Research and development expenses	32,016	27,043	95,868	80,630
Restructuring and impairment charges	264		93,948	8,720
Operating income (loss)	(34,231)	6,703	(174,724)	(30,245)
Other income (expenses)				
Interest expense, net	(13,946)	(14,944)	(43,031)	(42,836)
Foreign currency gain (loss), net	2,157	(5,473)	40,914	(4,667)
Loss before income taxes	(46,020)	(13,714)	(176,841)	(77,748)
Income tax expenses (benefits)	1,698	(472)	6,831	256
Net loss	$ (47,718)	$ (13,242)	$ (183,672)	$ (78,004)
Dividends accrued on preferred units	2,731	2,506	8,070	7,379
Net loss attributable to common units	$ (50,449)	$ (15,748)	$ (191,742)	$ (85,383)
Net loss per common unit				
- Basic and diluted	$ (0.96)	$ (0.30)	$ (3.62)	$ (1.62)
Weighted average number of units				
- Basic and diluted	52,720,976	53,037,320	52,975,152	52,848,430

The accompanying notes are an integral part of these financial statements

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MagnaChip Semiconductor LLC and Subsidiaries

Condensed Consolidated Balance Sheets

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

	October 1, 2006	December 31, 2005
Assets		
Current assets		
Cash and cash equivalents	$ 107,489	$ 86,574
Restricted cash		2,837
Accounts receivable, net	82,187	112,053
Inventories, net	59,289	88,677
Other receivables	6,709	9,501
Other current assets	12,728	10,148
Total current assets	268,402	309,790
Property, plant and equipment, net	355,431	485,077
Intangible assets, net	145,784	191,389
Other non-current assets	51,917	54,391
Total assets	$ 821,534	$ 1,040,647
Liabilities and Unitholders Equity		
Current liabilities		
Accounts payable	$ 59,151	$ 93,911
Other accounts payable	28,030	35,368
Accrued expenses	33,589	28,968
Other current liabilities	5,108	10,102
Total current liabilities	125,878	168,349
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	61,778	55,124
Other non-current liabilities	4,406	7,196
Total liabilities	942,062	980,669
Commitments and contingencies		
Series A redeemable convertible preferred units; 60,000 units authorized, 50,091 units issued and 0 unit outstanding at October 1, 2006 and December 31, 2005		
Series B redeemable convertible preferred units; 550,000 units authorized, 450,692 units issued and 93,997 units outstanding at October 1, 2006 and December 31, 2005	114,532	106,462
Total redeemable convertible preferred units	114,532	106,462
Unitholders equity		
Common units; 65,000,000 units authorized, 52,720,784 and 53,091,570 units issued and outstanding at October 1, 2006 and December 31, 2005, respectively	52,721	53,092
Additional paid-in capital	2,378	2,169
Accumulated deficit	(321,834)	(130,092)

Accumulated other comprehensive income	31,675	28,347
Total unitholders equity	(235,060)	(46,484)
Total liabilities, redeemable convertible preferred units and unitholders equity	$ 821,534	$ 1,040,647

The accompanying notes are an integral part of these financial statements

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MagnaChip Semiconductor LLC and Subsidiaries

Condensed Consolidated Statements of Cash Flows

(Unaudited; in thousands of US dollars)

	Nine months ended	
	October 1, 2006	**October 2, 2005**
Cash flows from operating activities		
Net loss	$ (183,672)	$ (78,004)
Adjustments to reconcile net loss to net cash provided by operating activities		
Depreciation and amortization	145,481	154,748
Provision for severance benefits	10,031	12,189
Amortization of debt issuance costs	2,760	2,561
Loss (gain) on foreign currency translation, net	(43,297)	5,451
Impairment of long-lived assets	92,540	7,996
Other	1,443	(2,522)
Changes in operating assets and liabilities		
Accounts receivable	36,804	(31,257)
Inventories	34,495	2,637
Other receivables	3,230	65,323
Deferred tax assets	1,405	(12,853)
Accounts payable	(39,955)	12,233
Other accounts payable	(16,870)	(76,377)
Accrued expenses	2,879	4,564
Other current assets	(1,255)	2,684
Other current liabilities	(5,100)	(438)
Payment of severance benefits	(7,116)	(10,664)
Other	2,768	(1,065)
Net cash provided by operating activities	36,571	57,206
Cash flows from investing activities		
Purchase of plant, property and equipment	(26,274)	(39,839)
Payments for intellectual property registration	(1,746)	(1,614)
Acquisition of business, net of cash acquired of $4,620 thousand		(11,831)
Proceeds from disposal of plant, property and equipment	2,748	537
Proceeds from disposal of intangible assets	2,801	
Decrease in restricted cash	2,985	7,876
Other	(700)	2,583
Net cash used in investing activities	(20,186)	(42,288)
Cash flows from financing activities		
Repayment of short-term borrowings		(12,400)
Exercise of unit options	88	
Repurchase of common units	(420)	
Proceeds from short-term borrowings		10,578
Other		(80)
Net cash used in financing activities	(332)	(1,902)
Effect of exchange rates on cash and cash equivalents	4,862	(385)
Net increase in cash and cash equivalents	20,915	12,631

Cash and cash equivalents		
Beginning of the period	86,574	58,396
End of the period	$ 107,489	$ 71,027

The accompanying notes are an integral part of these financial statements

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements

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

1. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements of MagnaChip Semiconductor LLC and its subsidiaries (the Company) have been prepared in accordance with Accounting Principle Board (APB) Opinion No. 28, *Interim Financial Reporting* regarding interim financial information and, accordingly, do not include all of the information and note disclosures required by generally accepted accounting principles in the United States of America for complete financial statements. In the opinion of the Company s management, the unaudited interim condensed consolidated financial statements include all normal recurring adjustments necessary to fairly present the information required to be set forth therein. All inter-company accounts and transactions have been eliminated. These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2005, which was filed with the SEC on March 31, 2006. The results of operations for the three-month and nine-month periods ended October 1, 2006 are not necessarily indicative of the results to be expected for a full year or for any other periods.

Recent accounting pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statements of Financial Accounting Standards (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 158 is effective for fiscal years ending after December 15, 2008. The Company does not expect that the implementation of SFAS No. 158 will have a material impact on its 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 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy, as defined and may be required to provide additional disclosures based on that hierarchy. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact that the adoption may have on its consolidated financial statements.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin (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. The Company does not expect that adoption of SAB 108 will have a material impact on its consolidated financial statements.

In June 2006, the FASB issued FASB Interpretation (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. The Company does not expect that adoption of this Interpretation will have a material impact on its 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 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 156 is effective in fiscal years beginning after September 15, 2006. The adoption of SFAS 156 is not expected to have a material impact on the Company s consolidated financial statements.

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

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 remeasurement 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 Company does not expect that adoption of this Statement will have a material impact on its consolidated financial statements.

2. Inventories

Inventories as of October 1, 2006 and December 31, 2005 consist of the following:

	October 1, 2006	December 31, 2005
Finished goods	$ 20,471	$ 28,414
Semi-finished goods and work-in-progress	43,904	60,095
Raw materials	7,756	5,814
Materials in-transit	1,306	1,966
Less: Valuation allowance	(14,148)	(7,612)
Inventories, net	$ 59,289	$ 88,677

3. Property, plant and equipment

Property, plant and equipment as of October 1, 2006 and December 31, 2005 comprise the following:

	October 1, 2006	December 31, 2005
Buildings and related structures	$ 159,612	$ 149,236
Machinery and equipment	358,319	472,388
Vehicles and others	38,657	32,438
	556,588	654,062
Less: Accumulated depreciation	(213,564)	(181,806)
Land	12,270	11,492
Construction in-progress	137	1,329
Property, plant and equipment, net	$ 355,431	$ 485,077

Assets held-for-sale

In connection with the sale of the Company s application processor business, which was finalized in January 2006, the Company identified and segregated related tangible assets as held-for-sale and ceased depreciating for such assets. As of October 1, 2006, the remaining amount of held-for-sale assets was $4,193 thousand in total.

4. Intangible Assets

Intangible assets as of October 1, 2006 and December 31, 2005 are as follows:

	October 1, 2006	December 31, 2005
Technology	$ 20,929	$ 23,911
Customer relationships	167,681	193,958
Goodwill	15,095	15,095
Intellectual property assets	9,555	10,969
Less: Accumulated amortization	(67,476)	(52,544)
Intangible assets, net	$ 145,784	$ 191,389

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

5. Product Warranties

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

Changes in accrued warranty liabilities are as follows:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Beginning balance	$ 207	$ 2,925	$ 1,036	$ 1,448
Addition to (reversal of) warranty reserve	12	(1,518)	(563)	1,500
Payments made	(69)	(187)	(377)	(1,705)
Translation adjustments	2	17	56	(6)
Ending balance	$ 152	$ 1,237	$ 152	$ 1,237

6. Long-term Borrowings

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

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

Details of long-term borrowings as of October 1, 2006 and December 31, 2005 are presented as below:

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

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

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

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

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

As of October 1, 2006, the Company and all of its subsidiaries except for MagnaChip Semiconductor (Shanghai) Company Limited have jointly and severally guaranteed each series of the Second Priority Senior Secured Notes on a second priority senior secured basis. As of October 1, 2006, the Company and its subsidiaries except for MagnaChip Semiconductor Ltd. (Korea) and MagnaChip Semiconductor (Shanghai) Company Limited have jointly and severally guaranteed the Senior Subordinated Notes on an unsecured, senior subordinated basis. In addition, the Company and each of its current and future direct and indirect subsidiaries (subject to certain exceptions) will be guarantors of Second Priority Senior Secured Notes and Senior Subordinated Notes.

During the third quarter, the Company entered into the Fourth Amendment to Credit Agreement (as amended, the Credit Agreement), dated as of July 26, 2006 (the Amendment), with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders party thereto (the Lenders), UBS AG, Stamford Branch, as administrative agent and collateral agent (the Agent), and U.S. Bank National Association (US Bank).

Under the Amendment, among other things, (i) the Company agreed to furnish to the Agent and the Lenders monthly financial statements along with an officer s certificate with respect to the occurrence of any events of default under the Credit Agreement, (ii) certain restrictions were imposed on the Company s ability to make acquisitions and capital expenditures, (iii) the financial covenants set forth in Section 6.10 of the Credit Agreement were revised, (iv) the schedule of applicable margins under the Credit Agreement was revised, (v) the Lenders, the Agent and US Bank waived certain defaults and obligations, and (vi) the Agent consented to the Company s voting in favor of increasing the share capital of one of the Company s subsidiaries.

Interest Rate Swap

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

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

For the nine-month period ended October 1, 2006, the Company recorded changes in the fair value of the Swap amounting to $87 thousand, under other comprehensive income in the accompanying condensed consolidated financial statements. In addition, during the same period, the Company recognized interest income of $1,973 thousand, which represents the differences between fixed and variable rates.

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

7. Accrued Severance Benefits

The majority of accrued severance benefits is for employees in the Company s Korean subsidiary. Pursuant to the Labor Standards Act of Korea, most employees and executive officers with one or more years of service are entitled to severance benefits upon the termination of their employment based on their length of service and rate of pay. As of October 1, 2006, 97% of all employees of the Company were eligible for severance benefits.

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

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Beginning balance	$ 60,793	$ 53,870	$ 56,967	$ 52,925
Provisions	4,675	4,063	10,031	12,189
Transferred from acquired company				196
Severance payments	(2,557)	(3,201)	(7,116)	(10,664)
Effect of foreign currency translation and other	669	(694)	3,698	(608)
Ending balance	63,580	54,038	63,580	54,038
Less: Cumulative contributions to the National Pension Fund	(866)	(950)	(866)	(950)
Group severance insurance plan	(936)	(922)	(936)	(922)
	$ 61,778	$ 52,166	$ 61,778	$ 52,166

The severance benefits are funded approximately 2.83% and 3.46% as of October 1, 2006 and October 2, 2005, respectively, through the Company s National Pension Fund and group severance insurance plan which will be used exclusively for payment of severance benefits to eligible employees. These amounts have been deducted from the accrued severance benefit balance.

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

	Severance benefit
2006 2008	$
2009	70
2010	213
2011 2015	1,705

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

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

8. Redeemable Convertible Preferred Unit

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

Changes in Series B for the three and nine months ended October 1, 2006 are as follows:

	Three months ended			
	October 1, 2006		October 2, 2005	
	Units	Amount	Units	Amount
Beginning of period	93,997	$ 111,801	93,997	$ 101,407
Accrual of preferred dividends		2,731		2,506
End of period	93,997	$ 114,532	93,997	$ 103,913

	Nine months ended			
	October 1, 2006		October 2, 2005	
	Units	Amount	Units	Amount
Beginning of period	93,997	$ 106,462	93,997	$ 96,534
Accrual of preferred dividends		8,070		7,379
End of period	93,997	$ 114,532	93,997	$ 103,913

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

9. Earnings per Unit

The following table illustrates the computation of basic and diluted loss per common unit for the three and nine months ended October 1, 2006 and October 2, 2005:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Net loss	$ (47,718)	$ (13,242)	$ (183,672)	$ (78,004)
Dividends to preferred unitholders	2,731	2,506	8,070	7,379
Net loss attributable to common units	$ (50,449)	$ (15,748)	$ (191,742)	$ (85,383)
Weighted-average common units outstanding	52,720,976	53,037,320	52,975,152	52,848,430

Basic and diluted loss per unit	$	(0.96)	$	(0.30)	$	(3.62)	$	(1.62)

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

	October 1, 2006	October 2, 2005
Redeemable convertible preferred units	93,997	93,997
Options	4,909,152	3,536,080
Warrant (subsequently expired)	5,079,254	5,079,254

MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

In connection with the acquisition of the Company s business from Hynix Semiconductor Inc. on October 6, 2004, by Citigroup Venture Capital Equity Partners, L.P., or CVC, Francisco Partners L.P., or Francisco Partners, CVC Asia Pacific Limited, or CVC Asia Pacific (the Original Acquisition), the Company issued a warrant to Hynix which enables Hynix to purchase 5,079,254 common units of the Company at an exercise price of $1.00 per unit. This warrant expired unexercised in accordance with its terms on October 6, 2006.

10. Equity Incentive Plans

The Company adopted two equity incentive plans effective October 6, 2004 and March 21, 2005, respectively, which are administered by the Compensation Committee designated by the board of directors. Employees, consultants and non-employee directors are eligible for the grant of options to purchase the Company s common units or restricted common units subject to terms and conditions determined by the Committee. The term of options in no event exceed ten years from the date of grant. As of October 1, 2006, an aggregate maximum of 7,890,864 common units were authorized and reserved for all future and outstanding grants of options.

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

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

The following summarizes unit option and restricted unit activities for the three and nine months ended October 1, 2006:

	Number of restricted units	Number of options	Weighted average exercise price (in US dollars)	Weighted average remaining contractual life
Outstanding at January 1, 2006	1,726,062	3,780,643	1.6	
Granted		1,808,500	1.4	
Exercised	n/a	41,688	2.0	
Forfeited / Repurchased	409,348	439,569	1.6	
Released from restriction	517,936	n/a		
Outstanding at July 2, 2006	798,778	5,107,886	1.5	
Granted		41,000	3.0	
Exercised	n/a	4,375	1.4	
Forfeited		235,359	1.3	
Released from restriction	88,406	n/a		
Outstanding at October 1, 2006	710,372	4,909,152	1.5	8.7 years
Exercisable at October 1, 2006	n/a	1,409,701	1.6	8.1 years

Effective January 1, 2006, the Company adopted SFAS 123(R), *Share-Based Payment (revised 2004).* As the Company elected to use the modified prospective application method, no restatement was made to the condensed consolidated statements of operations for prior interim periods or fiscal years. Under SFAS 123(R), the Company is required to measure compensation cost for all unit-based awards at fair value on the date of grant and recognize compensation expense over the grantee s requisite service period. As permitted under SFAS No. 123(R), the

Company elected to recognize compensation expense for all options with graded vesting based on the graded attribution method.

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Total unit option related compensation expense for the three and nine months ended October 1, 2006 was $67 thousand and $170 thousand, respectively. As of October 1, 2006, total unrecognized compensation cost of $458 thousand is expected to be recognized over a weighted average future period of 1.54 years.

Prior to the first quarter of 2006, the Company accounted for its unit-based compensation using the intrinsic value method prescribed in APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and provided the required pro forma disclosures of SFAS No. 123, *Accounting for Stock-Based Compensation.* The following presents pro forma net loss and per unit data as if the fair value based method had been applied to account for the unit-based compensation for three and nine months ended October 2, 2005:

	Three months ended October 2, 2005	Nine months ended October 2, 2005
As reported net loss	$ (13,242)	$ (78,004)
Add: Amortization of non-cash deferred unit compensation expense determined under the intrinsic value method as reported in net loss, net of tax		
Deduct: Total unit-based compensation expense determined under the fair value method for all awards, net of tax	(109)	(327)
Pro forma net loss	$ (13,351)	$ (78,331)
Pro forma loss per unit	$ (0.30)	$ (1.62)

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

	Three months ended	
	October 1, 2006	October 2, 2005
Grant-date fair value of options (in US dollars)	0.05	0.09
Expected term	2.3Years	2.3Years
Risk-free interest rate	5.1%	3.9%
Expected volatility	44.9%	53.7%
Expected dividends		

	Nine months ended	
	October 1, 2006	October 2, 2005
Grant-date fair value of options (in US dollars)	0.25	0.22
Expected term	2.3Years	2.2Years
Risk-free interest rate	4.9%	3.0%
Expected volatility	46.7%	60.3%
Expected dividends		

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

The total cash received from employees as a result of option exercises was $6 thousand and $88 thousand for the three and nine months ended October 1, 2006, respectively. None of the options exercised during these periods had any intrinsic value.

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

11. Restructuring and Impairment Charges

In the second quarter of 2006, the Company recorded impairment charges of $92,540 thousand related to one of its fabrication facilities and certain related technology and customer-based intangible assets in accordance with SFAS 144, *Accounting for the Impairment or Disposal of Long-lived assets*. During the same quarter, the Company recorded restructuring charges of $1,144 thousand in association with changes in certain of the Company s management and related severance agreements. In addition, during the third quarter of 2006, the Company executed an early retirement for certain qualified employees and, as a result, recognized restructuring charges of $264 thousand.

12. Comprehensive Income

Comprehensive income is as follows:

	Three months ended October 1,		Nine months ended	
	2006	October 2, 2005	October 1, 2006	October 2, 2005
Net loss	$ (47,718)	$ (13,242)	$ (183,672)	$ (78,004)
Change in fair value of derivatives	(3,223)	2,962	87	3,045
Foreign currency translation effect	(1,648)	(1,246)	3,241	1,286
Comprehensive loss	$ (52,589)	$ (11,526)	$ (180,344)	$ (73,673)

13. Segment Information

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

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

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

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

The following sets forth information relating to the reportable segments:

	Three months ended		Nine months ended	
	October 1, 2006	October 2, 2005	October 1, 2006	October 2, 2005
Net Sales				
Display Solutions	$ 56,056	$ 92,638	$ 215,116	$ 223,715
Imaging Solutions	12,691	36,952	47,691	130,418
Semiconductor Manufacturing Services	84,440	92,069	280,838	250,723
All other	18,096	21,430	38,394	87,646
Total segment net sales	$ 171,283	$ 243,089	$ 582,039	$ 692,502
Gross Profit				
Display Solutions	$ 5,238	$ 23,260	$ 31,308	$ 45,251
Imaging Solutions	2,708	7,231	(5,302)	22,986
Semiconductor Manufacturing Services	5,037	30,059	46,259	76,466
All other	7,878	1,362	9,195	3,565
Total segment gross profit	$ 20,861	$ 61,912	$ 81,460	$ 148,268

14. Condensed Consolidating Financial Statements

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

Below are condensed consolidating balance sheets as of October 1, 2006 and December 31, 2005, condensed consolidating statements of operations for the three and nine months ended October 1, 2006 and October 2, 2005 and condensed consolidating statements of cash flows for the nine months ended October 1, 2006 and October 2, 2005 of those entities that guarantee the Senior Subordinated Notes, those that do not, MagnaChip Semiconductor LLC, and the co-issuers.

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the three months ended October 1, 2006

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 163,459	$ 90,972	$ (83,148)	$ 171,283
Cost of sales			147,484	77,306	(74,368)	150,422
Gross profit			15,975	13,666	(8,780)	20,861
Selling, general and administrative expenses	18	231	19,197	3,420	(54)	22,812
Research and development expenses			37,053	3,828	(8,865)	32,016
Restructuring and impairment charges			264			264
Operating income (loss)	(18)	(231)	(40,539)	6,418	139	(34,231)
Other income (expenses)	2	(4,287)	(10,787)	3,283		(11,789)
Income (loss) before income taxes, equity in loss of related equity investment	(16)	(4,518)	(51,326)	9,701	139	(46,020)
Income tax expenses		40	50	1,608		1,698
Income (loss) before equity in loss of related Investment	(16)	(4,558)	(51,376)	8,093	139	(47,718)
Loss of related investment	(47,702)	(48,981)		(51,473)	148,156	
Net loss	$ (47,718)	$ (53,539)	$ (51,376)	$ (43,380)	$ 148,295	$ (47,718)
Dividends accrued on preferred units	2,731					2,731
Net loss attributable to common units	$ (50,449)	$ (53,539)	$ (51,376)	$ (43,380)	$ 148,295	$ (50,449)

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the nine months ended October 1, 2006

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 561,282	$ 291,357	$ (270,600)	$ 582,039
Cost of sales			494,361	263,159	(256,941)	500,579
Gross profit			66,921	28,198	(13,659)	81,460
Selling, general and administrative expenses	86	748	56,969	8,619	(54)	66,368
Research and development expenses			99,798	10,813	(14,743)	95,868
Restructuring and impairment charges			93,723	225		93,948
Operating income (loss)	(86)	(748)	(183,569)	8,541	1,138	(174,724)
Other income (expenses)	2	6,134	2,481	(10,734)		(2,117)
Income (loss) before income taxes, equity in loss of related equity investment	(84)	5,386	(181,088)	(2,193)	1,138	(176,841)
Income tax expenses		122	50	6,659		6,831
Income (loss) before equity in loss of related Investment	(84)	5,264	(181,138)	(8,852)	1,138	(183,672)
Loss of related investment	(183,588)	(193,848)		(181,611)	559,047	
Net loss	$ (183,672)	$ (188,584)	$ (181,138)	$ (190,463)	$ 560,185	$ (183,672)
Dividends accrued on preferred units	8,070					8,070
Net loss attributable to common units	$ (191,742)	$ (188,584)	$ (181,138)	$ (190,463)	$ 560,185	$ (191,742)

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the three months ended October 2, 2005

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 239,454	$ 115,232	$ (111,597)	$ 243,089
Cost of sales			182,430	105,692	(106,945)	181,177
Gross profit			57,024	9,540	(4,652)	61,912
Selling, general and administrative expenses	238	822	26,595	3,675	(3,164)	28,166
Research and development expenses			24,123	3,723	(803)	27,043
Restructuring and impairment charges						
Operating income (loss)	(238)	(822)	6,306	2,142	(685)	6,703
Other income (expenses)	1	5,764	(18,495)	(7,687)		(20,417)
Income (loss) before income taxes, equity in loss of related equity investment	(237)	4,942	(12,189)	(5,545)	(685)	(13,714)
Income tax expenses (benefits)		15		(487)		(472)
Income (loss) before equity in loss of related Investment	(237)	4,927	(12,189)	(5,058)	(685)	(13,242)
Loss of related investment	(13,005)	(17,464)		(8,752)	39,221	
Net loss	$ (13,242)	$ (12,537)	$ (12,189)	$ (13,810)	$ 38,536	$ (13,242)
Dividends accrued on preferred units	2,506					2,506
Net loss attributable to common units	$ (15,748)	$ (12,537)	$ (12,189)	$ (13,810)	$ 38,536	$ (15,748)

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Operations

For the nine months ended October 2, 2005

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Net sales	$	$	$ 673,969	$ 318,381	$ (299,848)	$ 692,502
Cost of sales			540,155	299,970	(295,891)	544,234
Gross profit			133,814	18,411	(3,957)	148,268
Selling, general and administrative expenses	353	1,408	77,369	12,058	(2,025)	89,163
Research and development expenses			75,731	6,841	(1,942)	80,630
Restructuring and impairment charges			8,720			8,720
Operating loss	(353)	(1,408)	(28,006)	(488)	10	(30,245)
Other income (expenses)	6	(11,065)	(43,147)	6,703		(47,503)
Income (loss) before income taxes, equity in loss of related equity investment	(347)	(12,473)	(71,153)	6,215	10	(77,748)
Income tax expenses		123		133		256
Income (loss) before equity in loss of related Investment	(347)	(12,596)	(71,153)	6,082	10	(78,004)
Loss of related investment	(77,657)	(60,600)		(68,916)	207,173	
Net loss	$ (78,004)	$ (73,196)	$ (71,153)	$ (62,834)	$ 207,183	$ (78,004)
Dividends accrued on preferred units	7,379					7,379
Net loss attributable to common units	$ (85,383)	$ (73,196)	$ (71,153)	$ (62,834)	$ 207,183	$ (85,383)

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Balance Sheet

October 1, 2006

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Assets						
Current assets						
Cash and cash equivalents	$ 413	$ 1,489	$ 88,220	$ 17,367	$	$ 107,489
Restricted cash						
Accounts receivable, net			95,847	40,648	(54,308)	82,187
Inventories, net			55,294	4,205	(210)	59,289
Other receivables		718	4,188	36,205	(34,402)	6,709
Other current assets		26,160	12,714	11,178	(37,324)	12,728
Total current assets	413	28,367	256,263	109,603	(126,244)	268,402
Property, plant and equipment, net			354,084	1,347		355,431
Intangible assets, net			122,279	23,505		145,784
Investments in subsidiaries	(120,923)	(195,731)		(33,468)	350,122	
Long-term inter-company loans		785,080		634,101	(1,419,181)	
Other non-current assets		22,341	43,171	10,249	(23,844)	51,917
Total assets	$ (120,510)	$ 640,057	$ 775,797	$ 745,337	$ (1,219,147)	$ 821,534
Liabilities and Unitholders equity						
Current liabilities						
Accounts payable	$	$	$ 63,263	$ 50,196	$ (54,308)	$ 59,151
Other accounts payable		6	54,462	7,964	(34,402)	28,030
Accrued expenses	18	11,596	28,023	27,608	(33,656)	33,589
Other current liabilities		285	2,229	6,262	(3,668)	5,108
Total current liabilities	18	11,887	147,977	92,030	(126,034)	125,878
Long-term borrowings		750,000	621,000	798,181	(1,419,181)	750,000
Accrued severance benefits, net			61,506	272		61,778
Other non-current liabilities			2,621	25,629	(23,844)	4,406
Total liabilities	18	761,887	833,104	916,112	(1,569,059)	942,062
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred unites	114,532					114,532
Total redeemable convertible preferred units	114,532					114,532

Unitholders equity						
Common units	52,721	136,229	39,005	55,773	(231,007)	52,721
Additional paid-in capital	2,378	1,338	155,352	108,165	(264,855)	2,378
Accumulated deficit	(321,834)	(291,514)	(280,804)	(362,501)	934,819	(321,834)
Accumulated other comprehensive income	31,675	32,117	29,140	27,788	(89,045)	31,675
Total unitholders equity	(235,060)	(121,830)	(57,307)	(170,775)	349,912	(235,060)
Total liabilities, redeemable convertible preferred units and unitholders equity	$ (120,510)	$ 640,057	$ 775,797	$ 745,337	$ (1,219,147)	$ 821,534

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Balance Sheet

December 31, 2005

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Assets						
Current assets						
Cash and cash equivalents	$ 209	$ 841	$ 63,435	$ 22,089	$	$ 86,574
Restricted cash			2,837			2,837
Accounts receivable, net			131,669	55,057	(74,673)	112,053
Inventories, net			82,348	7,638	(1,309)	88,677
Other receivables	35,013	718	7,792	20,097	(54,119)	9,501
Other current assets		22,382	9,987	6,063	(28,284)	10,148
Total current assets	35,222	23,941	298,068	110,944	(158,385)	309,790
Property, plant and equipment, net			484,019	1,058		485,077
Intangible assets, net			165,369	26,020		191,389
Investments in subsidiaries	25,756	(38,942)		144,131	(130,945)	
Long-term inter-company loans		774,199		621,311	(1,395,510)	
Other non-current assets		24,153	45,370	11,131	(26,263)	54,391
Total assets	$ 60,978	$ 783,351	$ 992,826	$ 914,595	$ (1,711,103)	$ 1,040,647
Liabilities and Unitholders equity						
Current liabilities						
Accounts payable	$	$	$ 94,581	$ 74,003	$ (74,673)	$ 93,911
Other accounts payable	1,000	440	68,703	19,344	(54,119)	35,368
Accrued expenses		3,139	24,560	26,331	(25,062)	28,968
Other current liabilities		162	3,746	9,416	(3,222)	10,102
Total current liabilities	1,000	3,741	191,590	129,094	(157,076)	168,349
Long-term borrowings		750,000	621,311	774,199	(1,395,510)	750,000
Accrued severance benefits, net			54,854	270		55,124
Other non-current liabilities			5,272	28,187	(26,263)	7,196
Total liabilities	1,000	753,741	873,027	931,750	(1,578,849)	980,669
Commitments and contingencies						
Series A redeemable convertible preferred units						
Series B redeemable convertible preferred unites	106,462					106,462
Total redeemable convertible preferred units	106,462					106,462

Unitholders equity						
Common units	53,092	102,986	39,005	58,364	(200,355)	53,092
Additional paid-in capital	2,169	1,027	155,212	71,989	(228,228)	2,169
Accumulated deficit	(130,092)	(102,930)	(99,666)	(172,038)	374,634	(130,092)
Accumulated other comprehensive income	28,347	28,527	25,248	24,530	(78,305)	28,347
Total unitholders equity	(46,484)	29,610	119,799	(17,155)	(132,254)	(46,484)
Total liabilities, redeemable convertible preferred units and unitholders equity	$ 60,978	$ 783,351	$ 992,826	$ 914,595	$ (1,711,103)	$ 1,040,647

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Cash Flows

For the nine months ended October 1, 2006

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Cash flow from operating activities						
Net loss	$ (183,672)	$ (188,584)	$ (181,138)	$ (190,463)	$ 560,185	$ (183,672)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			142,376	3,105		145,481
Provision for severance benefits			10,029	2		10,031
Amortization of debt issuance costs		2,084	676			2,760
Loss (gain) on foreign currency translation, net		(10,882)	(43,674)	11,259		(43,297)
Impairment of long-lived assets			92,540			92,540
Loss of related investment	183,588	193,848		181,611	(559,047)	
Other			1,687	(2,663)	2,419	1,443
Changes in operating assets and liabilities						
Accounts receivable			42,450	14,719	(20,365)	36,804
Inventories			32,150	3,444	(1,099)	34,495
Other receivables	1,603		4,070	4,173	(6,616)	3,230
Deferred tax assets				1,405		1,405
Accounts payable			(36,691)	(23,629)	20,365	(39,955)
Other accounts payable	(1,000)	(435)	(23,807)	1,756	6,616	(16,870)
Accrued expenses	17	8,457	1,721	1,278	(8,594)	2,879
Other current assets		(3,778)	(320)	(6,197)	9,040	(1,255)
Other current liabilities		122	(1,794)	(2,982)	(446)	(5,100)
Payment of severance benefits			(7,116)			(7,116)
Other		(184)	5,533	(162)	(2,419)	2,768
Net cash provided by (used in) operating activities	536	648	38,692	(3,344)	39	36,571
Cash flows from investing activities						
Purchase of plant, property and equipment			(25,574)	(700)		(26,274)
Payments for intellectual property registration			(1,687)	(59)		(1,746)
Proceeds from disposal of plant, property and equipment			2,748			2,748
Proceeds from disposal of intangible assets			2,801			2,801
Decrease in restricted cash			2,985			2,985
Other			(704)	4		(700)
Net cash used in investing activities			(19,431)	(755)		(20,186)
Cash flows from financing activities						
Exercise of unit options	88					88
Repurchase of common units	(420)					(420)

Net cash used in financing activities	(332)					(332)
Effect of exchange rate on cash and cash equivalents			5,524	(623)	(39)	4,862
Net increase (decrease) in cash and cash equivalents	204	648	24,785	(4,722)		20,915
Cash and cash equivalents						
Beginning of the period	209	841	63,435	22,089		86,574
End of the period	$ 413	$ 1,489	$ 88,220	$ 17,367	$	$ 107,489

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MagnaChip Semiconductor LLC and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Continued)

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

Condensed Consolidating Statement of Cash Flows

For the nine months ended October 2, 2005

	MagnaChip Semiconductor LLC (Parent)	Co-Issuers	Non-Guarantors	Guarantors	Eliminations	Consolidated
Cash flow from operating activities						
Net loss	$ (78,004)	$ (73,196)	$ (71,153)	$ (62,834)	$ 207,183	$ (78,004)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities						
Depreciation and amortization			149,561	5,187		154,748
Provision for severance benefits			12,117	72		12,189
Amortization of debt issuance costs		1,955	606			2,561
Loss (gain) on foreign currency translation, net		19,059	4,181	(17,789)		5,451
Impairment of long-lived assets			7,996			7,996
Loss of related investment	77,657	60,600		68,916	(207,173)	
Other			(2,589)	67		(2,522)
Changes in operating assets and liabilities						
Accounts receivable			(30,556)	(11,105)	10,404	(31,257)
Inventories			87	2,029	521	2,637
Other receivables	(241)	826	65,289	(33,970)	33,419	65,323
Deferred tax assets				(12,853)		(12,853)
Accounts payable			16,567	6,070	(10,404)	12,233
Other accounts payable	(160)	183	(72,206)	29,225	(33,419)	(76,377)
Accrued expenses		10,403	3,644	19,777	(29,260)	4,564
Other current assets		(21,100)	2,285	(7,761)	29,260	2,684
Other current liabilities		123	(5,455)	4,894		(438)
Payment of severance benefits			(10,653)	(11)		(10,664)
Other			(31,611)	32,458	(1,912)	(1,065)
Net cash provided by (used in) operating activities	(748)	(1,147)	38,110	22,372	(1,381)	57,206
Cash flows from investing activities						
Purchase of plant, property and equipment			(39,729)	(511)	401	(39,839)
Payments for intellectual property registration			(1,614)			(1,614)
Acquisition of business	(1,870)			(9,961)		(11,831)
Proceeds from disposal of plant, property and equipment			425	513	(401)	537
Increase in short-term inter-company loans				(14,000)	14,000	
Increase in long-term inter-company loans		(1,009)		(1,009)	2,018	
Decrease in restricted cash			7,876			7,876
Other			2,572	11		2,583
Net cash used in investing activities	(1,870)	(1,009)	(30,470)	(24,957)	16,018	(42,288)

Cash flows from financing activities						
Proceeds from short-term inter-company borrowings				14,000	(14,000)	
Proceeds from short-term borrowings			10,578			10,578
Proceeds from long-term inter-company borrowings			1,009	1,009	(2,018)	
Repayment of short-term borrowings				(12,400)		(12,400)
Other	513	(378)	(215)			(80)
Net cash provided by (used in) financing activities	513	(378)	11,372	2,609	(16,018)	(1,902)
Effect of exchange rate on cash and cash equivalents			68	(1,834)	1,381	(385)
Net increase (decrease) in cash and cash equivalents	(2,105)	(2,534)	19,080	(1,810)		12,631
Cash and cash equivalents						
Beginning of the period	2,386	3,201	29,671	23,138		58,396
End of the period	$ 281	$ 667	$ 48,751	$ 21,328	$	$ 71,027

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PART I. Financial Information (continued)

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

The following Management s Discussion and Analysis of Financial Condition and Results of Operations contain forward-looking statements within the meaning of the federal securities laws that involve risks and uncertainties. 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-Q and in prior Company public filings with the SEC. In addition, other factors have been or may be discussed from time to time in the Company s SEC filings. These forward looking statements are made based on 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 unaudited condensed consolidated interim financial statements and related notes included elsewhere in this Form 10-Q. 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.

Our business was named MagnaChip Semiconductor when it was acquired from Hynix Semiconductor Inc. on October 6, 2004, by CVC, Francisco Partners, CVC Asia Pacific, certain members of management and other investors.

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 phones, digital still cameras, photo printers, games, monitors, and LCD TVs. 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 is focused on the high growth camera phone market, offering video graphics adapter (VGA), 1.3, 2.1 and 3.1 megapixel CMOS image sensors. Our highly integrated image sensors are designed to be more cost effective and to provide brighter, sharper and more colorful image quality.

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 niche markets such as high-voltage, embedded memory 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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Results of Operations Comparison of Three-Month Periods Ended October 1, 2006 and October 2, 2005

The following table sets forth consolidated result of operations for the three months ended October 1, 2006 and October 2, 2005:

	Three months ended October 1, 2006		Three months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 171.3	100.0	$ 243.1	100.0	$ (71.8)	(29.5)
Cost of sales	150.4	87.8	181.2	74.5	(30.8)	(17.0)
Gross profit	20.9	12.2	61.9	25.5	(41.0)	(66.2)
Selling, general and administrative expenses	22.8	13.3	28.2	11.6	(5.4)	(19.1)
Research and development expenses	32.0	18.7	27.0	11.1	5.0	18.5
Restructuring and impairment charges	0.3	0.2			0.3	100
Operating income (loss)	(34.2)	(20.0)	6.7	2.8	(40.9)	(610.4)
Interest expense, net	(13.9)	(8.1)	(14.9)	(6.1)	1.0	(6.7)
Foreign currency gain (loss), net	2.1	1.2	(5.5)	(2.3)	7.6	(138.2)
Loss before income taxes	(46.0)	(26.9)	(13.7)	(5.6)	(32.3)	235.8
Income tax expenses (benefits)	1.7	1.0	(0.5)	(0.2)	2.2	(440.0)
Net loss	$ (47.7)	(27.9)	$ (13.2)	(5.4)	$ (34.5)	261.4

Net Sales and Gross Profit for Display Solutions

	Three months ended October 1, 2006		Three months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 56.1	100.0	$ 92.6	100.0	$ (36.5)	(39.4)
Cost of sales	50.8	90.6	69.4	74.9	(18.6)	(26.8)
Gross profit	$ 5.3	9.4	$ 23.2	25.1	$ (17.9)	(77.2)

Display Solutions net sales for the three months ended October 1, 2006 were $56.1 million, a $36.5 million or 39.4% decrease from $92.6 million for the three months ended October 2, 2005. The year-over-year decrease in net sales is primarily due to a lower market demand resulting mainly from inventory adjustments and product transition in our major customers. Declines in average selling price also had a negative impact on net sales.

Gross profit in the third quarter of 2006 was $5.3 million or 9.4% of net sales, compared to $23.2 million or 25.1% of net sales in the prior-year quarter. Decrease in gross profit both on an absolute dollar basis and on a percentage basis was primarily attributable to average selling price erosion year over year and an increase in overhead costs per unit driven by a volume decline during the current quarter.

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Net Sales and Gross Profit for Imaging Solutions

	Three months ended October 1, 2006		Three months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 12.7	100.0	$ 37.0	100.0	$ (24.3)	(65.7)
Cost of sales	10.0	78.7	29.7	80.3	(19.7)	(66.3)
Gross profit	$ 2.7	21.3	$ 7.3	19.7	$ (4.6)	(63.0)

Imaging Solutions net sales for the three months ended October 1, 2006 were $12.7 million, a $24.3 million or 65.7% decrease from $37.0 million for the three months ended October 2, 2005. Continued average selling price pressure for VGA products, which accounts for 77% of total Imaging Solutions revenue, coupled with the timing of new design wins in megapixel products ramping into volume production, resulted in the revenue decrease in this segment.

Gross profit for the three months ended October 1, 2006 was $2.7 million or 21.3% of net sales, compared to $7.3 million or 19.7% of net sales for the three months ended October 2, 2005. The improvement in gross profit, on a percentage basis, was mainly attributable to reduced depreciation expenses that resulted from impairment charges taken against one of our fabrication facilities during the second quarter of 2006.

Net Sales and Gross Profit for Semiconductor Manufacturing Services

	Three months ended October 1, 2006		Three months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 84.4	100.0	$ 92.1	100.0	$ (7.7)	(8.4)
Cost of sales	79.4	94.1	62.0	67.3	17.4	28.1
Gross profit	$ 5.0	5.9	$ 30.1	32.7	$ (25.1)	(83.4)

Semiconductor Manufacturing Services net sales in the third quarter of 2006 were $84.4 million, a $7.7 million or 8.4% decline from net sales of $92.1 million in the prior year period. This decline in quarterly net sales was primarily attributable to lower demand in the analog and display driver portion of our foundry business as well as a shift in mix to older generation services.

Gross profit for the three months ended October 1, 2006 was $5.0 million or 5.9% of net sales, compared to $30.1 million or 32.7% of net sales for the three months ended October 2, 2005. Decrease in average selling price and lower margin mix compared to the prior year s third quarter resulted in a decline of gross profit for the segment.

Net Sales and Gross Profit for All Other

	Three months ended October 1, 2006		Three months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					

Net sales	$ 18.1	100.0	$ 21.4	100.0	$ (3.3)	(15.4)
Cost of sales	10.2	56.4	20.1	94.0	(9.9)	(49.3)
Gross profit	$ 7.9	43.6	$ 1.3	6.0	$ 6.6	(507.7)

The All other category represents certain business activities other than business segments, such as rental fees and unit processing fees. All other in the third quarter of 2005 also included certain business activities discontinued in late 2005 or early 2006. Net sales were $18.1 million and $21.4 million in the third quarter of 2006 and 2005, respectively. The decline of $3.3 million represents the revenue from the discontinued application processor and DRAM foundry business, partially offset by increase in revenue from unit processing.

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Gross profit in the third quarter of 2006 was $7.9 million, an increase of $6.6 million from the gross profit of $1.3 million during the prior year quarter. The improvement in gross profit is mainly attributable to the discontinuation of the less profitable application processor and DRAM foundry business.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general, and administrative expenses were $22.8 million or 13.3% of net sales for the three months ended October 1, 2006 compared to $28.2 million or 11.6% for the three months ended October 2, 2005. The decrease of $5.4 million or 19.1% from the prior-year quarter was primarily attributable to reduced professional fees related to consulting and infrastructure build-out as well as decreased warranty expenses related to customer claims. In addition, lower amortization costs of intangible assets due to impairment charges in the prior quarter resulted in a decrease in selling, general, and administrative expenses for the current period.

Research and Development Expenses. Research and development expenses for the current quarter were $32.0 million, an increase of $5.0 million or 18.5% from $27.0 million for the prior year quarter. This increase in research and development expenses was mainly attributable to higher manufacturing cost for products used in our R&D activities, coupled with higher professional fees. As a percentage of net sales, research and development expense in the third quarter of 2006 increased to 18.7% from 11.1% of net sales in the third quarter of 2005.

Restructuring and Impairment Charges. During the three months ended October 1, 2006, we recorded restructuring charges of $0.3 million in accordance with SFAS 146, *Accounting for Costs Associated with Exit or Disposal Activities*. The restructuring charges relate to termination benefits provided for certain employees under an early retirement program.

Net Interest Expense and Income Tax Expenses

Net Interest Expense. Net interest expense was $13.9 million during the three-month period ended October 1, 2006, a decline of $1.0 million from $14.9 million for the three-month period ended October 2, 2005. The decline in net interest expense was mainly due to an increase in interest income from financial assets including cash and cash equivalents. Our interest expense is mostly to serve the long-term borrowings of $750.0 million, which include $300 million of Floating Rate Second Priority Senior Secured Notes. As a result of an interest rate swap entered into in the second quarter of 2005, the variable interest rate of such Notes was effectively converted to a fixed rate and we are not exposed to changes in interest rates until the interest rate swap is unwound on June 15, 2008. Refer to Note 6. Long-term Borrowings for details.

Income Tax Expenses. Income tax expenses for the current quarter were $1.7 million compared to income tax benefits of $0.5 million for the same quarter of 2005. The income tax benefits in the third quarter of 2005 were primarily attributable to the effect of deferred tax accounting, where we recognized deferred tax assets for certain temporary differences between taxable and accounting income. Excluding this deferred tax effect, our income tax expenses are mostly composed of withholding taxes on inter-company interest payments and, therefore, consistent among periods.

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Results of Operations - Comparison of Nine-Month Periods Ended October 1, 2006 and October 2, 2005

The following table sets forth consolidated result of operations for the nine months ended October 1, 2006 and October 2, 2005:

	Nine months ended October 1, 2006		Nine months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 582.0	100.0	$ 692.5	100.0	$ (110.5)	(16.0)
Cost of sales	500.6	86.0	544.2	78.6	(43.6)	(8.0)
Gross profit	81.4	14.0	148.3	21.4	(66.9)	(45.1)
Selling, general and administrative expenses	66.4	11.4	89.2	12.9	(22.8)	(25.6)
Research and development expenses	95.9	16.5	80.6	11.6	15.3	19.0
Restructuring and impairment charges	93.9	16.1	8.7	1.3	85.2	979.3
Operating loss	(174.8)	(30.0)	(30.2)	(4.4)	(144.6)	478.8
Interest expense, net	(43.0)	(7.4)	(42.8)	(6.2)	(0.2)	0.5
Foreign currency gain (loss), net	40.9	7.0	(4.7)	(0.7)	45.6	(970.2)
Loss before income taxes	(176.9)	(30.4)	(77.7)	(11.3)	(99.2)	127.7
Income tax expenses	6.8	1.2	0.3	0.0	6.5	2,166.7
Net loss	$ (183.7)	(31.6)	$ (78.0)	(11.3)	$ (105.7)	135.5

Net Sales and Gross Profit for Display Solutions

	Nine months ended October 1, 2006		Nine months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 215.1	100.0	$ 223.7	100.0	$ (8.6)	(3.8)
Cost of sales	183.8	85.4	178.5	79.8	5.3	3.0
Gross profit	$ 31.3	14.6	$ 45.2	20.2	$ (13.9)	(30.8)

Display Solutions net sales for the nine months ended October 1, 2006 were $215.1 million, a $8.6 million or 3.8% decrease from $223.7 million for the nine months ended October 2, 2005. The decrease in year-to-date net sales for Display Solutions resulted from a relatively steep sales decrease during the third quarter of 2006, which is primarily attributable to a reduction in market demand. A decrease in average selling price also had an impact on the net sales decrease.

Gross profit for the nine-month period ended October 1, 2006 was $31.3 million or 14.6% of net sales, compared to $45.2 million or 20.2% of net sales for the nine-month period ended October 2, 2005. A decrease in gross profit both on an absolute dollar and a percentage basis was primarily attributable to average selling price erosion and an increase in per-unit overhead costs driven by a volume decrease.

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Net Sales and Gross Profit for Imaging Solutions

	Nine months ended October 1, 2006		Nine months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 47.7	100.0	$ 130.4	100.0	$ (82.7)	(63.4)
Cost of sales	53.0	111.1	107.4	82.4	(54.4)	(50.7)
Gross profit (loss)	$ (5.3)	(11.1)	$ 23.0	17.6	$ (28.3)	(123.0)

Imaging Solutions net sales for the nine months ended October 1, 2006 were $47.7 million, an $82.7 million or 63.4% decrease from $130.4 million for the nine months ended October 2, 2005. Continued average selling price pressure for VGA products and delayed transition to new megapixel products resulted in the revenue decrease in this segment.

Gross loss for the nine months ended October 1, 2006 was $5.3 million, compared to gross profit of $23.0 million for the nine months ended October 2, 2005. This decline in gross profit was mainly attributable to average selling price erosion as well as charges under SFAS No. 151, *Inventory Costs*. In accordance with SFAS No. 151, certain manufacturing overhead costs were expensed rather than being capitalized as inventory due to under-utilization of certain fabrication facilities.

Net Sales and Gross Profit for Semiconductor Manufacturing Services

	Nine months ended October 1, 2006		Nine months ended October 2, 2005		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
	(in millions of US dollars; %)					
Net sales	$ 280.8	100.0	$ 250.7	100.0	$ 30.1	12.0
Cost of sales	234.6	83.5	174.3	69.5	60.3	34.6
Gross profit	$ 46.2	16.5	$ 76.4	30.5	$ (30.2)	(39.5)

Net sales for Semiconductor Manufacturing Services, during the nine-month period ended October 1, 2006, were $280.8 million, a $30.1 million or 12.0% increase compared to net sales of $250.7 million in the year ago period. The decrease in average selling price was more than offset by an increase in sales volume driven by expanded market demand.

Gross profit for the nine months ended October 1, 2006 was $46.2 million or 16.5% of net sales, compared to $76.4 million or 30.5% of net sales for the nine months ended October 2, 2005. The year-over-year decrease of $30.2 or 39.5% was primarily attributable to average selling price erosion, coupled with lower margin mix within the business segment.

Net Sales and Gross Profit for All other

	Nine months ended October 1, 2006	Nine months ended October 2, 2005		Change	
	Amount	Amount	% of	Amount	%

		% of net sales		**net sales**		
			(in millions of US dollars; %)			
Net sales	$ 38.4	100.0	$ 87.7	100.0	$ (49.3)	(56.2)
Cost of sales	29.2	76.0	84.0	95.8	(54.8)	(65.2)
Gross profit	$ 9.2	24.0	$ 3.7	4.2	$ 5.5	148.6

The All other category represents certain business activities other than business segments, such as rental fees and unit processing fees. All other in the prior-year period also included certain business activities discontinued in late 2005 or early 2006. Net sales for the current period were $38.4 million compared to net sales of $87.7 million in the prior-year period. The decline of $49.3 million represents the revenue from the discontinued application processor and DRAM foundry business, partially offset by an increase in revenue from unit processing.

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Gross profit for the nine-month period ended October 1, 2006 was $9.2 million, an increase of $5.5 million from the gross profit of $3.7 million during the prior-year period. The improvement in gross profit is mainly attributable to the discontinuation of the less profitable application processor and DRAM foundry business.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general, and administrative expenses were $66.4 million or 11.4% of net sales for the nine months ended October 1, 2006 compared to $89.2 million or 12.9% for the nine months ended October 2, 2005. This decrease of $22.8 million or 25.6% from the prior-year period was primarily attributable to lower amortization of intangible assets resulting from impairment charges taken during prior quarters, coupled with a decrease in professional service fees and reserve provisions for customer claims and returns.

Research and Development Expenses. Research and development expenses for the current period were $95.9 million, a $15.3 million or 19.0% increase from $80.6 million for the prior-year period. This increase in research and development expenses represents increased technology license fees and additional research and development staffing and activity from the acquisition of ISRON Corporation and IC Media Corporation. As a percentage of net sales, research and development expense increased 16.5% in the current period compared to 11.6% in the prior-year period.

Restructuring and Impairment Charges. During the nine months ended October 1, 2006, we recorded a one-time charge of $93.9 million as restructuring and impairment charges. The amount included $92.5 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 were recorded against one of our fabrication facilities and certain related technology and customer-based intangible assets, and the restructuring charges were taken in association with changes in certain of our management and employee early retirements. In the prior-year period, $8.7 million of restructuring and impairment charges were recorded in connection with an impairment of certain tangible assets and an early retirement program.

Net Interest Expenses and Income Tax Expenses

Net Interest Expense. Net interest expense was $43.0 million during the nine-month period ended October 1, 2006, consistent with $42.8 million for the nine-month period ended October 2, 2005. Our interest expense is mostly to serve the Company s long-term borrowings of $750.0 million, which includes $300 million of Floating Rate Second Priority Senior Secured Notes. As a result of an interest rate swap entered into in the second quarter of 2005, the variable interest rate of such Notes was effectively converted to a fixed rate and we are not exposed to changes in interest rates until the interest rate swap is unwound on June 15, 2008. Refer to Note 6. Long-term Borrowings for details.

Income Tax Expenses. Income tax expenses for the nine months ended October 1, 2006 were $6.8 million while income tax expenses were $0.3 million for the prior year period. The lower income tax expenses in the prior-year period were primarily attributable to the effect of deferred tax accounting, where we recognized deferred tax assets for certain temporary differences between taxable and accounting income. Excluding the impact from deferred tax accounting, our income tax expenses are mostly composed of withholding taxes on the interest paid by one of our subsidiaries to its parent company and consistent over the periods.

Liquidity and Capital Resources

Our principal capital requirements are to fund working capital needs, meet required debt payments, including debt service payments on our notes and, if drawn upon, the senior credit facility, to invest in research and development and capital equipment expenditures. 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, and fund our research and development expenses, capital expenditures and service requirements on our debt obligations for the foreseeable future. As of October 1, 2006, we had total long-term debt outstanding of $750.0 million.

During the nine-month period ended October 1, 2006, we generated cash from operating activities of $36.6 million, an $20.6 million or 36.0% decrease from operating cash inflow of $57.2 million during the third quarter of 2005. The operating cash inflows for the nine-month period reflected our net loss of $183.7 million adjusted by non-cash items of $209.0 million which consisted mostly of impairment charges, depreciation costs and amortization costs. On top of these cash inflows on an adjusted basis, we had a cash increase of $11.3 million resulting primarily from a decrease in working capital requirements during the nine months ended October 1, 2006.

Our working capital balance was $142.5 million as of October 1, 2006, relatively consistent with $141.4 million as of December 31, 2005. Excluding cash and cash equivalents, the working capital balance was decreased by $19.8 million, from $54.9 million to $35.1 million. The decrease was driven mainly by reductions in accounts receivable and inventories totaling $59.3 million, partially offset by a decrease of $42.1 million in accounts and other payable.

For investing activities, we used cash of approximately $20.2 million for the nine months ended October 1, 2006. This cash outlay principally represented $28.0 million of capital expenditures on tangible and intangible assets, partially offset by a cash inflow from the sale of our application processor business and other tangible assets. During the prior-year quarter, the net cash outlay for investing activities was $42.3 million.

For the nine months ended October 1, 2006, there were no significant financing activities. During the first nine months of 2005, we used approximately $1.9 million in financing activities.

Capital Expenditures. For the nine months ended October 1, 2006, capital expenditures were $28.0 million, a $13.5 million or 32.5% decrease from $41.5 million for the nine months ended October 2, 2005 as a result of the management of the timing of capital expenditures. We will continue to manage the timing of our capital expenditures to support the growth of business from new customers and to optimize return on our investment.

Future Financing Activities. Our primary future capital requirements include funding of our working capital needs, meeting our required debt payments, and funding of research and development as well as capital equipment expenditures. We plan to add design resources in low cost locations in Asia. We anticipate that our operating cash flows, together with available borrowings under our senior credit facility, will be sufficient to meet these capital requirements for the foreseeable future.

From time to time, we may need to incur additional debt or issue equity to make strategic acquisitions and 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 October 1, 2006.

	Payments Due by Period							
	Total	**2006**	**2007**	**2008**	**2009**	**2010**	**Thereafter**	**Interest expense**
	(in millions of US dollars)							
Revolving credit facility								
Secured notes and subordinated notes(*)	750.0						750.0	
Operating lease	58.8	2.8	11.2	11.2	11.2	11.2	11.2	
Others	12.7	4.8	7.3	0.9			0.1	(0.4)

(*) Excludes interest obligations on 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 $^{7}/_{8}$% 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.

On July 26, 2006, we entered into the Amendment with MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, as borrowers, the Subsidiary Guarantors party thereto, the Lenders , the Agent and US Bank.

Under the Amendment, among other things, (i) we agreed to furnish to the Agent and the Lenders monthly financial statements along with an officer s certificate with respect to the occurrence of any events of default under the Credit

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Agreement, (ii) certain restrictions were imposed on our ability to make acquisitions and capital expenditures, (iii) the financial covenants set forth in Section 6.10 of the Credit Agreement were revised, (iv) the schedule of applicable margins under the Credit Agreement was revised, (v) the Lenders, the Agent and US Bank waived certain defaults and obligations, and (vi) the Agent consented to our voting in favor of increasing the share capital of one of our subsidiaries.

Off Balance Sheet Arrangements

On December 23, 2004, two of our subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company entered into a senior 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 October 1, 2006 and December 31, 2005 were $90.9 million and $83.0 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 158 is effective for fiscal year ending after December 15, 2008. 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 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 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. The adoption of this Interpretation is not expected to have a material impact 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 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 156 is effective in fiscal years beginning after September 15, 2006. The adoption of SFAS 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 remeasurement 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

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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.

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 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 shipment 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. The establishment of reserves for sales discounts is based on judgment that requires significant estimates of a variety of factors, including forecasted demand, returns and industry pricing assumptions. We record warranty liabilities for the estimated costs that may be incurred under our limited warranty. This warranty covers product defects based on compliance 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.

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.

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

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 demonstrated 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

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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.

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.

Contingencies and Litigation

We are subject to the possibility of losses from various contingencies. Considerable judgment is necessary to estimate the probability and amount of any loss from such contingencies. An accrual is made when it is probable that a liability has been incurred or an asset has been impaired and the amount of loss can be reasonably estimated. In such case, we accrue a liability and charge operations for the estimated costs of adjudication or settlement of the applicable asserted and unasserted claims existing as of the balance sheet date.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk is the risk that the value of a financial instrument will fluctuate due to changes in market conditions, including changes in interest rates and foreign exchange rates. In the normal course of our business, we are subject to market risk associated with interest rate movements and currency movements on our assets and liabilities.

Foreign Currency Risk. We have exposure to foreign currency exchange-rate fluctuations on net income from our subsidiaries denominated in currencies other than U.S. dollars, as our foreign subsidiaries in Korea, Taiwan, China, Japan and Hong Kong use local currency as their functional currency. From time to time these subsidiaries have cash and financial instruments in local currency. The amounts held in Japan, Taiwan, Hong Kong and China are not material in regards to foreign currency movements. However, based on the cash and financial instruments balance at October 1, 2006 for our Korean subsidiary, a 10% devaluation of the Korean Won against the U.S. dollar would have resulted in a decrease of $1.4 million in our U.S. dollar financial instruments balance and cash balance.

Interest Rate Risk. The $200 million 6 ^{7}/8% 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 October 1, 2006, we estimate that

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we would have additional interest expense costs over the market rate of $2.8 million for the nine months ended October 1, 2006. The fair value of these fixed rate notes would have decreased by $9.0 million or increased by $9.3 million with a 10% increase or decrease in the interest rate, respectively.

Cash Flow Interest Rate Risk. In 2005, we entered into an interest rate swap agreement to convert the variable interest rate on our Floating Rate Second Priority Senior Secured Notes to a fixed interest rate for the periods to maturity date of June 2008. With this interest rate swap, cash flow interest rate risk was replaced with exposure to interest rate risk. For details, refer to Note 6. Long-term Borrowings.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As required by the Securities Exchange Act of 1934, as amended (the Exchange Act), our management, including our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO), conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. As defined in Rule 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures that we use that are designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our CEO and our CFO, as appropriate, to allow timely decisions regarding required disclosure.

Based upon that evaluation, our CEO and our CFO concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report.

Internal Control Over Financial Reporting

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

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PART II OTHER INFORMATION

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 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 229 customers in the nine-month period ended October 1, 2006, net sales to our 10 largest customers represented approximately 58.8% 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 nine-month period ended October 1, 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.

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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 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 November 1, 2006, approximately 62% 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.

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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.

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. As a division of Hynix, we were able to take advantage of Hynix s size and purchasing power in procuring parts and materials. As an independent company, we are smaller and less diversified than Hynix, and we may be unable to obtain parts and materials at prices and on terms as favorable as those available to us prior to the separation from Hynix in October 2004. 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 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.

As a business segment of Hynix, we were the beneficiary of some of Hynix s intellectual property arrangements, including cross-licensing arrangements with other leading semiconductor companies and licenses from third parties of technology incorporated in our products and used to operate our business. We are no longer a beneficiary under some of these agreements and arrangements. There may be third parties who had refrained from asserting intellectual property infringement claims against our products or processes while we were a business segment of Hynix that elect to pursue such claims against us now that we are an independent company. In addition, some of our technologies have been sublicensed from Hynix on a non-exclusive basis and Hynix may sublicense such technologies to others. We have cross-licensed most of our technologies to Hynix. This cross-license is subject to the non-competition provision of the Hynix business transfer agreement. Our competitors may develop, patent or gain access to similar know-how and technology. Failure to protect our existing intellectual property rights may result in the loss of valuable technologies or 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, 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%, 34% and 18%, 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.

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

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of intellectual property. These risks may lead to increased costs or decreased revenue growth, or both.

Escalating 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. In October 2006, the level of tension increased as a result of a North Korean nuclear weapons test and the subsequent imposition of economic sanctions by member nations of the United Nations. 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.

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

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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. In addition, 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 2. Unregistered Sales of Equity Securities and Use of Proceeds.

During the three-month period ended October 1, 2006, one of our subsidiary s former employees exercised options to acquire 4,375 of our common units at a purchase price of $5,998.13. Because the offering transaction took place outside the U.S. and the optionee was not a U.S. person, these securities were exempt from registration under Regulation S of the Securities Act of 1933, as amended.

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Item 6. Exhibits.

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

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SIGNATURES

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

	MAGNACHIP SEMICONDUCTOR LLC
Dated: November 14, 2006	By: /s/ Sang Park Sang Park Chief Executive Officer and President
Dated: November 14, 2006	By: /s/ Robert J. Krakauer Robert J. Krakauer Executive Vice President, Corporate Operations, and Chief Financial Officer

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INDEX TO EXHIBITS

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