
**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2017

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: 001-34791

MagnaChip Semiconductor Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

c/o MagnaChip Semiconductor S.A.
1, Allée Scheffer, L-2520
Luxembourg, Grand Duchy of Luxembourg
(352) 45-62-62

(Address, zip code, and telephone number, including area code, of registrant's principal executive offices)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer" "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

| | | | |
|-------------------------|--|---------------------------|-------------------------------------|
| Large accelerated filer | <input type="checkbox"/> | Accelerated filer | <input checked="" type="checkbox"/> |
| Non-accelerated filer | <input type="checkbox"/> (Do not check if a smaller reporting company) | Smaller reporting company | <input type="checkbox"/> |
| Emerging growth company | <input type="checkbox"/> | | |

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of October 31, 2017, the registrant had 34,138,289 shares of common stock outstanding.

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PART I—FINANCIAL INFORMATION

Item 1. Interim Consolidated Financial Statements (Unaudited)

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS (Unaudited)

| | September 30, 2017 | December 31, 2016 |
|---|--|----------------------|
| | (In thousands of US dollars, except share data) | |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 128,425 | \$ 83,355 |
| Restricted cash (Note 12) | — | 18,251 |
| Accounts receivable, net | 86,046 | 61,775 |
| Inventories, net | 57,162 | 57,048 |
| Other receivables | 2,944 | 5,864 |
| Prepaid expenses | 12,654 | 8,137 |
| Hedge collateral | 9,520 | 3,150 |
| Other current assets | 3,641 | 5,113 |
| Total current assets | <u>300,392</u> | <u>242,693</u> |
| Property, plant and equipment, net | 186,390 | 179,793 |
| Intangible assets, net | 3,748 | 3,085 |
| Long-term prepaid expenses | 13,074 | 9,556 |
| Deferred income tax assets | 274 | 193 |
| Other non-current assets | 4,805 | 6,632 |
| Total assets | <u>\$ 508,683</u> | <u>\$ 441,952</u> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities | | |
| Accounts payable | \$ 54,304 | \$ 51,509 |
| Other accounts payable | 12,319 | 12,272 |
| Accrued expenses | 45,324 | 60,365 |
| Deferred revenue | 9,465 | 11,092 |
| Deposits received (Note 12) | 264 | 16,549 |
| Other current liabilities | 2,321 | 1,654 |
| Total current liabilities | <u>123,997</u> | <u>153,441</u> |
| Long-term borrowings, net | 302,894 | 221,082 |
| Accrued severance benefits, net | 132,288 | 129,225 |
| Other non-current liabilities | 10,632 | 10,318 |
| Total liabilities | <u>569,811</u> | <u>514,066</u> |
| Commitments and Contingencies (Note 18) | | |
| Stockholders' equity | | |
| Common stock, \$0.01 par value, 150,000,000 shares authorized, 42,512,498 shares issued and 34,138,289 outstanding at September 30, 2017 and 41,627,103 shares issued and 35,048,338 outstanding at December 31, 2016 | 425 | 416 |
| Additional paid-in capital | 135,185 | 130,189 |
| Accumulated deficit | (84,542) | (125,825) |
| Treasury stock, 8,374,209 shares at September 30, 2017 and 6,578,765 shares at December 31, 2016 | (102,319) | (90,918) |
| Accumulated other comprehensive income (loss) | (9,877) | 14,024 |
| Total stockholders' deficit | <u>(61,128)</u> | <u>(72,114)</u> |
| Total liabilities and stockholders' equity | <u>\$ 508,683</u> | <u>\$ 441,952</u> |

The accompanying notes are an integral part of these consolidated financial statements.

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|---|-----------------------|-----------------------|-----------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| | (In thousands of US dollars, except share data) | | | |
| Net sales | \$ 176,697 | \$ 192,296 | \$ 505,092 | \$ 507,507 |
| Cost of sales | 126,387 | 153,157 | 366,550 | 397,370 |
| Gross profit | 50,310 | 39,139 | 138,542 | 110,137 |
| Operating expenses | | | | |
| Selling, general and administrative expenses | 17,266 | 20,082 | 58,144 | 60,437 |
| Research and development expenses | 17,554 | 18,439 | 52,440 | 54,432 |
| Restructuring and other charges (gain), net | — | — | (17,010) | (6,480) |
| Early termination charges | — | — | 13,369 | 4,240 |
| Total operating expenses | 34,820 | 38,521 | 106,943 | 112,629 |
| Operating income (loss) | 15,490 | 618 | 31,599 | (2,492) |
| Interest expenses | (5,485) | (4,055) | (16,099) | (12,185) |
| Foreign currency gain (loss), net | (3,662) | 33,174 | 26,219 | 34,268 |
| Other income, net | 198 | 887 | 1,892 | 2,429 |
| Income before income taxes | 6,541 | 30,624 | 43,611 | 22,020 |
| Income tax expenses | 937 | 758 | 2,328 | 1,845 |
| Net income | \$ 5,604 | \$ 29,866 | \$ 41,283 | \$ 20,175 |
| Income per common share— | | | | |
| Basic | \$ 0.16 | \$ 0.86 | \$ 1.22 | \$ 0.58 |
| Diluted | \$ 0.15 | \$ 0.85 | \$ 1.02 | \$ 0.58 |
| Weighted average number of shares— | | | | |
| Basic | 34,103,029 | 34,849,805 | 33,907,581 | 34,755,276 |
| Diluted | 45,542,418 | 35,302,706 | 44,438,871 | 35,077,315 |

The accompanying notes are an integral part of these consolidated financial statements.

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (Unaudited)

| | <u>Three Months Ended</u> | | <u>Nine Months Ended</u> | |
|--|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| | <u>September 30,</u> <u>2017</u> | <u>September 30,</u> <u>2016</u> | <u>September 30,</u> <u>2017</u> | <u>September 30,</u> <u>2016</u> |
| | (In thousands of US dollars) | | | |
| Net income | \$ 5,604 | \$ 29,866 | \$ 41,283 | \$ 20,175 |
| Other comprehensive income (loss) | | | | |
| Foreign currency translation adjustments | 2,692 | (27,340) | (23,270) | (27,193) |
| Derivative adjustments | | | | |
| Fair valuation of derivatives | (193) | (83) | 716 | (42) |
| Reclassification adjustment for gain on derivatives included in net income | (42) | — | (1,347) | — |
| Total other comprehensive income (loss) | <u>2,457</u> | <u>(27,423)</u> | <u>(23,901)</u> | <u>(27,235)</u> |
| Total comprehensive income (loss) | <u>\$ 8,061</u> | <u>\$ 2,443</u> | <u>\$ 17,382</u> | <u>\$ (7,060)</u> |

The accompanying notes are an integral part of these consolidated financial statements.

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY (Unaudited)

| (In thousands of US dollars, except share data) | Common Stock | | Additional Paid-In Capital | Accumulated Deficit | Treasury Stock | Accumulated Other Comprehensive Income (Loss) | Total |
|---|-------------------|---------------|----------------------------------|------------------------|--------------------|--|-------------------|
| | Shares | Amount | | | | | |
| Nine Months Ended September 30, 2017: | | | | | | | |
| Balance at January 1, 2017 | 35,048,338 | \$ 416 | \$130,189 | \$ (125,825) | \$ (90,918) | \$ 14,024 | \$(72,114) |
| Stock-based compensation | — | — | 1,614 | — | — | — | 1,614 |
| Exercise of stock options | 487,873 | 5 | 3,386 | — | — | — | 3,391 |
| Settlement of restricted stock units | 397,522 | 4 | (4) | — | — | — | — |
| Acquisition of treasury stock | (1,795,444) | — | — | — | (11,401) | — | (11,401) |
| Other comprehensive loss, net | — | — | — | — | — | (23,901) | (23,901) |
| Net income | — | — | — | 41,283 | — | — | 41,283 |
| Balance at September 30, 2017 | <u>34,138,289</u> | <u>\$ 425</u> | <u>\$135,185</u> | <u>\$ (84,542)</u> | <u>\$(102,319)</u> | <u>\$ (9,877)</u> | <u>\$(61,128)</u> |
| Nine Months Ended September 30, 2016: | | | | | | | |
| Balance at January 1, 2016 | 34,568,942 | \$ 411 | \$124,618 | \$ (96,210) | \$ (90,918) | \$ (231) | \$(62,330) |
| Stock-based compensation | — | — | 2,966 | — | — | — | 2,966 |
| Exercise of stock options | 255,500 | 3 | 1,500 | — | — | — | 1,503 |
| Settlement of restricted stock units | 162,812 | 1 | (1) | — | — | — | — |
| Other comprehensive loss, net | — | — | — | — | — | (27,235) | (27,235) |
| Net income | — | — | — | 20,175 | — | — | 20,175 |
| Balance at September 30, 2016 | <u>34,987,254</u> | <u>\$ 415</u> | <u>\$129,083</u> | <u>\$ (76,035)</u> | <u>\$ (90,918)</u> | <u>\$ (27,466)</u> | <u>\$(64,921)</u> |

The accompanying notes are an integral part of these consolidated financial statements.

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

| | Nine Months Ended | |
|--|-----------------------|-----------------------|
| | September 30, 2017 | September 30, 2016 |
| (In thousands of US dollars) | | |
| Cash flows from operating activities | | |
| Net income | \$ 41,283 | \$ 20,175 |
| Adjustments to reconcile net income to net cash used in operating activities | | |
| Depreciation and amortization | 20,689 | 18,791 |
| Provision for severance benefits | 15,354 | 13,609 |
| Amortization of debt issuance costs and original issue discount | 1,464 | 527 |
| Gain on foreign currency, net | (30,615) | (38,182) |
| Restructuring gain and other | (17,010) | (7,785) |
| Stock-based compensation | 1,614 | 2,966 |
| Other | 459 | 421 |
| Changes in operating assets and liabilities | | |
| Accounts receivable, net | (20,241) | 977 |
| Inventories, net | 3,281 | (9,412) |
| Other receivables | 5,304 | 20,214 |
| Other current assets | 2,897 | 510 |
| Accounts payable | 178 | 7,088 |
| Other accounts payable | (8,378) | (4,764) |
| Accrued expenses | (16,459) | (22,087) |
| Other current liabilities | (822) | (3,869) |
| Deferred revenue | (2,243) | 2,662 |
| Other non-current liabilities | 283 | (1,412) |
| Payment of severance benefits | (19,578) | (14,178) |
| Other | 35 | (182) |
| Net cash used in operating activities | <u>(22,505)</u> | <u>(13,931)</u> |
| Cash flows from investing activities | | |
| Proceeds from disposal of plant, property and equipment | 18,753 | 185 |
| Purchase of plant, property and equipment | (19,269) | (11,345) |
| Payment for intellectual property registration | (977) | (754) |
| Collection of guarantee deposits | 1,426 | 476 |
| Proceeds from settlement of hedge collateral | 8,556 | 6,317 |
| Payment of hedge collateral | (14,839) | (2,494) |
| Payment of guarantee deposits | (41) | (185) |
| Other | 24 | 9 |
| Net cash used in investing activities | <u>(6,367)</u> | <u>(7,791)</u> |
| Cash flows from financing activities | | |
| Proceeds from issuance of senior notes | 86,250 | — |
| Payment of debt issuance costs | (5,902) | — |
| Proceeds from exercise of stock options | 3,391 | 1,502 |
| Acquisition of treasury stock | (11,401) | — |
| Net cash provided by financing activities | <u>72,338</u> | <u>1,502</u> |
| Effect of exchange rates on cash and cash equivalents | 1,604 | 4,766 |
| Net increase (decrease) in cash and cash equivalents | <u>45,070</u> | <u>(15,454)</u> |
| Cash and cash equivalents | | |
| Beginning of the period | 83,355 | 90,882 |
| End of the period | <u>\$ 128,425</u> | <u>\$ 75,428</u> |
| Supplemental cash flow information | | |
| Cash paid for interest | <u>\$ 17,590</u> | <u>\$ 14,906</u> |
| Cash paid for income taxes | <u>\$ 830</u> | <u>\$ 635</u> |
| Non-cash operating activities | | |
| Insurance proceeds in restricted cash reclassified from other receivables | <u>\$ —</u> | <u>\$ (29,571)</u> |
| Non-cash investing activities | | |
| Property, plant and equipment additions in other accounts payable | <u>\$ 2,092</u> | <u>\$ 1,738</u> |

The accompanying notes are an integral part of these consolidated financial statements.

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(TABULAR DOLLARS IN THOUSANDS, EXCEPT SHARE DATA)**

1. Business, Basis of Presentation and Significant Accounting Policies

Business

MagnaChip Semiconductor Corporation (together with its subsidiaries, the “Company”) is a designer and manufacturer of analog and mixed-signal semiconductor platform solutions for communications, Internet of Things (“IoT”) applications, consumer, industrial and automotive applications. The Company provides technology platforms for analog, mixed signal, power, high voltage, non-volatile memory and Radio Frequency (“RF”) applications. The Company’s business is comprised of two operating segments: Foundry Services Group and Standard Products Group. The Company’s Foundry Services Group provides specialty analog and mixed-signal foundry services mainly for fabless and Integrated Device Manufacturer (“IDM”) semiconductor companies that primarily serve communications, IoT, consumer, industrial and automotive applications. The Company’s Standard Products Group is comprised of two business lines: Display Solutions and Power Solutions. The Company’s Display Solutions products provide panel display solutions to major suppliers of large and small rigid and flexible panel displays, and mobile, automotive applications and home appliances. The Company’s Power Solutions products include discrete and integrated circuit solutions for power management in communications, consumer and industrial applications.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles in the United States of America (“US GAAP”). These interim consolidated financial statements include normal recurring adjustments and the elimination of all intercompany accounts and transactions which are, in the opinion of management, necessary to provide a fair statement of the Company’s financial condition and results of operations for the periods presented. These interim consolidated financial statements are presented in accordance with Accounting Standards Codification 270, “*Interim Reporting*” and, accordingly, do not include all of the information and note disclosures required by US GAAP for complete financial statements. The results of operations for the three and nine months ended September 30, 2017 are not necessarily indicative of the results to be expected for a full year or for any other periods.

The December 31, 2016 balance sheet data was derived from the Company’s audited financial statements, but does not include all disclosures required by US GAAP.

Reclassifications

Certain charges related to the closure of the Company’s 6-inch fab and headcount reduction during 2016, previously included in selling, general and administrative expenses in the consolidated statements of operations, have been reclassified to restructuring and other charges (gain), net and early termination charges, respectively, to conform to the Company’s current year presentation. These reclassifications had no impact on the Company’s net income (loss), the consolidated balance sheets, the consolidated statements of comprehensive income (loss) and the consolidated statements of cash flows as previously reported.

Recent Accounting Pronouncements

In August 2017, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging Activities” (“ASU 2017-12”). ASU 2017-12 provides new guidance about income statement classification and eliminates the requirement to separately measure and report hedge ineffectiveness. The entire change in fair value for qualifying hedge instruments included in the effectiveness will be recorded in other comprehensive income (OCI) and amounts deferred in OCI will be reclassified to earnings in the same income statement line item in which the earnings effect of the hedged item is reported. ASU 2017-12 is effective for interim and annual periods for the Company on January 1, 2019, with early adoption permitted. The Company is currently evaluating the impact of adoption of ASU 2017-12 on its consolidated financial statements.

In July 2017, the FASB issued Accounting Standards Update No. 2017-11, “Earnings Per Share (Topic 260); Distinguishing Liabilities from Equity (Topic 480); Derivatives and Hedging (Topic 815)” (“ASU 2017-11”), which addresses the complexity of accounting for certain financial instruments with down round features. Down round features are features of certain equity-linked instruments (or embedded features) that result in the strike price being reduced on the basis of the pricing of future equity offerings. Current accounting guidance creates cost and complexity for entities that issue financial instruments (such as warrants and convertible instruments) with down round features that require fair value measurement of the entire instrument or conversion option. For public business entities, the amendments in ASU 2017-11 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. The Company is currently evaluating the impact of adoption of ASU 2017-11 on its consolidated financial statements.

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In May 2017, the FASB issued Accounting Standards Update No. 2017-09, “Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”). ASU 2017-09 provides clarity and reduces both (i) diversity in practice and (ii) cost and complexity when applying the guidance in Topic 718 to a change to the terms or conditions of a share-based payment award. The amendments in ASU 2017-09 provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. ASU 2017-09 is effective for fiscal years beginning after December 15, 2017, and interim periods within those years and early adoption is permitted. The Company does not expect the adoption of ASU 2017-09 to have a material effect on the Company’s consolidated financial statements.

In August 2016, the FASB issued Accounting Standards Update No. 2016-15, “Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”). ASU 2016-15 reduces the existing diversity in practice in financial reporting across all industries by clarifying certain existing principles in ASC 230, Statement of Cash Flows (“ASC 230”), including providing additional guidance on how and what an entity should consider in determining the classification of certain cash flows. In addition, in November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows (Topic 230), Restricted Cash (“ASU 2016-18”). ASU 2016-18 clarifies certain existing principles in ASC 230, including providing additional guidance related to transfers between cash and restricted cash and how entities present, in their statement of cash flows, the cash receipts and cash payments that directly affect the restricted cash accounts. These ASUs are effective for fiscal years beginning after December 15, 2017, and interim periods within those fiscal years. Early adoption is permitted. The Company does not expect the adoption of ASU 2016-15 to have a material effect on the Company’s consolidated financial statements. The adoption of ASU 2016-18 will impact the Company’s current disclosures as it will require including restricted cash within cash and cash equivalents on the statement of cash flows. These ASUs will be adopted in the first quarter of 2018.

In February 2016, the FASB issued Accounting Standards Update No. 2016-02, “Leases (Topic 842)” (“ASU 2016-02”) in order to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under US GAAP. ASU 2016-02 requires that a lessee should recognize a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term on the balance sheet. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those reporting periods using a modified retrospective approach and early adoption is permitted. The Company is performing a preliminary review of its contracts that are expected to be applied under the new guidance.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”). ASU 2014-09 supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605)”, and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Subsequently, the FASB approved a deferral included in ASU 2015-14 that permits public entities to apply the amendments in ASU 2014-09 for annual reporting periods beginning after December 15, 2017, including interim reporting periods therein, and that would also permit public entities to elect to adopt the amendments as of the original effective date as applicable to reporting periods beginning after December 15, 2016. The new guidance allows for the amendments to be applied either retrospectively to each prior reporting period presented or retrospectively as a cumulative-effect adjustment as of the date of adoption. In March 2016, the FASB issued ASU 2016-08, which clarifies the implementation guidance on principal versus agent considerations. In April 2016, the FASB issued ASU 2016-10, which clarifies identifying performance obligations and the licensing implementation guidance. In May 2016, the FASB issued ASU 2016-12, which improves certain aspects of ASC Topic 606 “Revenue from Contracts with Customers.” In December 2016, the FASB issued ASU 2016-20, which improves certain aspects of ASC Topic 606 “Revenue from Contracts with Customers.” The effective date and transition requirements for ASU 2016-08, ASU 2016-10, ASU 2016-12 and ASU 2016-20 are the same as the effective date and transition requirements of ASU 2014-09 (collectively, the “new revenue standard”).

The Company started analyzing the potential impact of applying the new guidance by reviewing its current accounting policies, customer arrangements and practices. The Company has assigned internal resources in addition to the engagement of third party service providers to assist in the evaluation. The Company’s in-progress analysis includes an evaluation of the terms of foundry services contracts and other arrangements that could potentially change the point in time revenue recognition to over time in proportion of wafer-manufacturing, which could have a material impact to the Company’s consolidated financial statements. The Company has not yet completed its assessment. As the Company continues its assessment, it is also identifying and preparing to implement appropriate changes to accounting policies, business processes and internal controls to support the new revenue standard and related disclosure requirements. The Company will adopt the new revenue standard on a modified retrospective basis on January 1, 2018.

Recently Adopted Accounting Pronouncements

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, “Simplifying the Measurement of Inventory” (“ASU 2015-11”). Under ASU 2015-11, inventory will be measured at the lower of cost and net realizable value, and options that currently exist for market value will be eliminated. Net realizable value is defined as the estimated selling prices in the ordinary course of

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business, less reasonably predictable costs of completion, disposal, and transportation. No other changes were made to the current guidance on inventory measurement. The Company adopted ASU 2015-11 in the first quarter of 2017, and the adoption of ASU 2015-11 did not impact the Company's consolidated financial statements.

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, "Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes" ("ASU 2015-17"). The amendments in ASU 2015-17 require an entity to classify all deferred tax assets and liabilities as noncurrent. The Company adopted ASU 2015-17 in the first quarter of 2017, and the impact on the Company's consolidated financial statements is immaterial.

In March 2016, the FASB issued Accounting Standards Update No. 2016-09, "Improvements to Employee Share-Based Payment Accounting" ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. The primary impact of adoption is the recognition of excess tax benefits within income tax provision rather than within stockholders' equity. The Company adopted ASU 2016-09 in the first quarter of 2017, and the adoption of ASU 2016-09 did not have a material impact to the Company's consolidated financial statements.

2. Sales of Accounts Receivable and Receivable Discount Program

The Company has entered into an agreement to sell selected trade accounts receivable to a financial institution from time to time since March 2012. After the sale, the Company does not retain any interest in the receivables and the applicable financial institution collects these accounts receivable directly from the customer. The proceeds from the sales of these accounts receivable totaled \$16,180 thousand and \$17,984 thousand for the nine months ended September 30, 2017 and 2016, respectively, and these sales resulted in pre-tax losses of \$47 thousand and \$56 thousand for the nine months ended September 30, 2017 and 2016, respectively, which are included in selling, general and administrative expenses in the consolidated statements of operations. Net proceeds of this accounts receivable sale program are recognized in the consolidated statements of cash flows as part of operating cash flows.

The Company uses receivable discount programs with certain customers. These discount arrangements allow the Company to accelerate collection of customers' receivables.

3. Inventories

Inventories as of September 30, 2017 and December 31, 2016 consist of the following (in thousands):

| | September 30, 2017 | December 31, 2016 |
|---|-----------------------|----------------------|
| Finished goods | \$ 11,386 | \$ 7,867 |
| Semi-finished goods and work-in-process | 39,898 | 46,653 |
| Raw materials | 10,795 | 7,846 |
| Materials in-transit | 1,172 | 1,859 |
| Less: inventory reserve | (6,089) | (7,177) |
| Inventories, net | <u>\$ 57,162</u> | <u>\$ 57,048</u> |

Changes in inventory reserve for the three and nine months ended September 30, 2017 and 2016 are as follows (in thousands):

| | Three Months Ended September 30, 2017 | Nine Months Ended September 30, 2017 | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2016 |
|---|---|--|---|--|
| Beginning balance | \$ (5,297) | \$ (7,177) | \$ (14,997) | \$ (16,033) |
| Change in reserve | | | | |
| Inventory reserve charged to costs of sales | (2,084) | (3,479) | (3,459) | (5,020) |
| Sale of previously reserved inventory | 816 | 3,380 | 5,025 | 5,339 |
| | (1,268) | (99) | 1,566 | 319 |
| Write off | 433 | 1,584 | 5,710 | 7,850 |
| Translation adjustments | 43 | (397) | (769) | (626) |
| Ending balance | <u>\$ (6,089)</u> | <u>\$ (6,089)</u> | <u>\$ (8,490)</u> | <u>\$ (8,490)</u> |

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Inventory reserve represents the Company's best estimate in value lost due to excessive inventory level, physical deterioration, obsolescence, changes in price levels, or other causes based on individual facts and circumstances. Inventory reserve relates to inventory items including finished goods, semi-finished goods and work-in-process. Write off of this reserve is recognized only when the related inventory has been disposed or scrapped.

Interim inventory reserves attributable to lower of cost or market caused by changes in market conditions may be reduced in subsequent interim periods within the same fiscal year to reflect recovery in market value.

4. Property, Plant and Equipment

Property, plant and equipment as of September 30, 2017 and December 31, 2016 are comprised of the following (in thousands):

| | September 30, 2017 | December 31, 2016 |
|------------------------------------|-----------------------|----------------------|
| Buildings and related structures | \$ 65,385 | \$ 64,939 |
| Machinery and equipment | 279,614 | 255,618 |
| Others | 35,597 | 29,492 |
| | 380,596 | 350,049 |
| Less: accumulated depreciation | (209,240) | (184,521) |
| Land | 15,034 | 14,265 |
| Property, plant and equipment, net | <u>\$ 186,390</u> | <u>\$ 179,793</u> |

Aggregate depreciation expenses totaled \$20,224 thousand and \$18,448 thousand for the nine months ended September 30, 2017 and 2016, respectively.

5. Intangible Assets

Intangible assets as of September 30, 2017 and December 31, 2016 are comprised of the following (in thousands):

| | September 30, 2017 | | |
|------------------------------|--------------------|-----------------------------|----------------|
| | Gross amount | Accumulated amortization | Net amount |
| Technology | \$18,868 | \$ (18,868) | \$ — |
| Customer relationships | 27,098 | (27,098) | — |
| Intellectual property assets | 10,401 | (6,653) | 3,748 |
| Intangible assets, net | <u>\$56,367</u> | <u>\$ (52,619)</u> | <u>\$3,748</u> |
| | December 31, 2016 | | |
| | Gross amount | Accumulated amortization | Net amount |
| Technology | \$17,903 | \$ (17,903) | \$ — |
| Customer relationships | 25,712 | (25,712) | — |
| Intellectual property assets | 9,026 | (5,941) | 3,085 |
| Intangible assets, net | <u>\$52,641</u> | <u>\$ (49,556)</u> | <u>\$3,085</u> |

Aggregate amortization expenses for intangible assets totaled \$465 thousand and \$343 thousand for the nine months ended September 30, 2017 and 2016, respectively.

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6. Accrued Expenses

Accrued expenses as of September 30, 2017 and December 31, 2016 are comprised of the following (in thousands):

| | September 30, 2017 | December 31, 2016 |
|---|-----------------------|----------------------|
| Payroll, benefits and related taxes, excluding severance benefits | \$ 17,436 | \$ 24,982 |
| Withholding tax attributable to intercompany interest income | 17,402 | 15,573 |
| Interest on senior notes | 3,463 | 6,831 |
| Outside service fees | 2,293 | 4,423 |
| Others | 4,730 | 8,556 |
| Accrued expenses | <u>\$ 45,324</u> | <u>\$ 60,365</u> |

7. Derivative Financial Instruments

The Company's Korean subsidiary from time to time has entered into zero cost collar and forward contracts to hedge the risk of changes in the functional-currency-equivalent cash flows attributable to currency rate changes on U.S. dollar denominated revenues.

Details of derivative contracts as of September 30, 2017 are as follows (in thousands):

| <u>Date of transaction</u> | <u>Type of derivative</u> | <u>Total notional amount</u> | <u>Month of settlement</u> |
|----------------------------|---------------------------|------------------------------|-------------------------------|
| June 22, 2017 | Zero cost collar | \$ 65,000 | October 2017 to February 2018 |
| June 22, 2017 | Forward | \$ 15,000 | October to December 2017 |
| September 28, 2017 | Zero cost collar | \$ 54,000 | January 2018 to June 2018 |
| September 28, 2017 | Forward | \$ 36,000 | January 2018 to June 2018 |

Details of derivative contracts as of December 31, 2016 are as follows (in thousands):

| <u>Date of transaction</u> | <u>Type of derivative</u> | <u>Total notional amount</u> | <u>Month of settlement</u> |
|----------------------------|---------------------------|------------------------------|----------------------------|
| November 11, 2016 | Zero cost collar | \$ 18,000 | March to August 2017 |

The zero cost collar and forward contracts qualify as cash flow hedges under Accounting Standards Codification 815, "Derivatives and Hedging," since at both the inception of the contracts and on an ongoing basis, the hedging relationship was and is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the contracts. 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."

The fair values of the Company's outstanding zero cost collar and forward contracts recorded as assets and liabilities as of September 30, 2017 and December 31, 2016 are as follows (in thousands):

| <u>Derivatives designated as hedging instruments:</u> | September 30, 2017 | December 31, 2016 |
|---|-----------------------|----------------------|
| Liabilities Derivatives: | | |
| Zero cost collars | \$ 1,257 | \$ 453 |
| Liabilities Derivatives: | | |
| Forwards | \$ 267 | \$ — |

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Offsetting of derivative assets and liabilities as of September 30, 2017 is as follows (in thousands):

| As of September 30, 2017 | Gross amounts of recognized assets/liabilities | Gross amounts offset in the balance sheets | Net amounts of assets/liabilities presented in the balance sheets | Gross amounts not offset in the balance sheets | | Net amount |
|--------------------------|--|--|---|--|-------------------------|------------|
| | | | | Financial instruments | Cash collateral pledged | |
| Liabilities Derivatives: | | | | | | |
| Zero cost collars | \$ 1,257 | \$ — | \$ 1,257 | \$ — | \$ (700) | \$ 557 |
| Liabilities Derivatives: | | | | | | |
| Forwards | \$ 267 | \$ — | \$ 267 | \$ — | \$ (120) | \$ 147 |

Offsetting of derivative liabilities as of December 31, 2016 is as follows (in thousands):

| As of December 31, 2016 | Gross amounts of recognized liabilities | Gross amounts offset in the balance sheets | Net amounts of liabilities presented in the balance sheets | Gross amounts not offset in the balance sheets | | Net amount |
|--------------------------|---|--|--|--|-------------------------|------------|
| | | | | Financial instruments | Cash collateral pledged | |
| Liabilities Derivatives: | | | | | | |
| Zero cost collars | \$ 453 | \$ — | \$ 453 | \$ — | \$ (650) | \$ (197) |

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (“AOCI”) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative, representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness, are recognized in current earnings.

The following table summarizes the impact of derivative instruments on the consolidated statement of operations for the three months ended September 30, 2017 and 2016 (in thousands):

| Derivatives in ASC 815 Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) | | Location of Gain Reclassified from AOCI into Statement of Operations (Effective Portion) | Amount of Gain Reclassified from AOCI into Statement of Operations (Effective Portion) | | Location of Loss Recognized in Statement of Operations on Derivative (Ineffective Portion) | Amount of Loss Recognized in Statement of Operations on Derivatives (Ineffective Portion) | |
|--|---|----------|--|--|-----------|--|---|---------|
| | Three Months Ended September 30, | | | Three Months Ended September 30, | | | Three Months Ended September 30, | |
| | 2017 | 2016 | | 2017 | 2016 | | 2017 | 2016 |
| | Zero cost collars | \$ (217) | | \$ (83) | Net sales | | \$ — | \$ — |
| Forwards | \$ 24 | \$ — | Net sales | \$ 42 | \$ — | Other income, net | \$ (228) | \$ — |
| Total | \$ (193) | \$ (83) | | \$ 42 | \$ — | | \$ (370) | \$ (32) |

The following table summarizes the impact of derivative instruments on the consolidated statement of operations for the nine months ended September 30, 2017 and 2016 (in thousands):

| Derivatives in ASC 815 Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) | | Location of Gain Reclassified from AOCI into Statement of Operations (Effective Portion) | Amount of Gain Reclassified from AOCI into Statement of Operations (Effective Portion) | | Location of Gain (Loss) Recognized in Statement of Operations on Derivative (Ineffective Portion) | Amount of Gain (Loss) Recognized in Statement of Operations on Derivatives (Ineffective Portion) | |
|--|---|---------|--|--|-----------|---|--|------|
| | Nine Months Ended September 30, | | | Nine Months Ended September 30, | | | Nine Months Ended September 30, | |
| | 2017 | 2016 | | 2017 | 2016 | | 2017 | 2016 |
| | Zero cost collars | \$ 666 | | \$ (42) | Net sales | | \$ 1,305 | \$ — |
| Forwards | \$ 50 | \$ — | Net sales | \$ 42 | \$ — | Other income, net | \$ (327) | \$ — |
| Total | \$ 716 | \$ (42) | | \$ 1,347 | \$ — | | \$ (200) | \$ 1 |

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As of September 30, 2017, the amount expected to be reclassified from accumulated other comprehensive income (loss) into loss within the next twelve months is \$1,067 thousand.

The Company set aside \$8,700 thousand and \$2,500 thousand cash deposits to the counterparty, Nomura Financial Investment (Korea) Co., Ltd. (“NFIK”) for the zero cost collar and forward contracts outstanding as of September 30, 2017 and for the zero cost collar contracts outstanding as of December 31, 2016, respectively. These cash deposits are recorded as hedge collateral on the consolidated balance sheets.

The Company is required to deposit additional cash collateral with NFIK for any exposure in excess of \$500 thousand, and \$820 thousand and \$650 thousand of additional cash collateral were required and recorded as hedge collateral on the consolidated balance sheets as of September 30, 2017 and December 31, 2016, respectively. These outstanding zero cost collar contracts and forward contracts are subject to termination if the sum of qualified and unrestricted cash and cash equivalents held by the Company is less than \$30,000 thousand on the last day of a fiscal quarter.

8. Fair Value Measurements

Fair Value of Financial Instruments

As of September 30, 2017, the following table represents the Company’s liabilities measured at fair value on a recurring basis and the basis for that measurement (in thousands):

| | <u>Carrying Value</u> | <u>Fair Value Measurement</u> | <u>Quoted Prices in Active Markets for Identical Asset (Level 1)</u> | <u>Significant Other Observable Inputs (Level 2)</u> | <u>Significant Unobservable Inputs (Level 3)</u> |
|--|-----------------------|-------------------------------|--|--|--|
| Liabilities: | | | | | |
| Derivative liabilities (other current liabilities) | \$ 1,524 | \$ 1,524 | — | \$ 1,524 | — |

As of December 31, 2016, the following table represents the Company’s liabilities measured at fair value on a recurring basis and the basis for that measurement (in thousands):

| | <u>Carrying Value</u> | <u>Fair Value Measurement</u> | <u>Quoted Prices in Active Markets for Identical Asset (Level 1)</u> | <u>Significant Other Observable Inputs (Level 2)</u> | <u>Significant Unobservable Inputs (Level 3)</u> |
|--|-----------------------|-------------------------------|--|--|--|
| Liabilities: | | | | | |
| Derivative liabilities (other current liabilities) | \$ 453 | \$ 453 | — | \$ 453 | — |

Items not reflected in the table above include cash and cash equivalents, accounts receivable, other receivables, accounts payable, and other accounts payable, fair value of which approximate carrying values due to the short-term nature of these instruments. The fair value of assets and liabilities whose carrying value approximates fair value is determined using Level 2 inputs.

Fair Value of Long-term Borrowings

| | <u>September 30, 2017</u> | | <u>December 31, 2016</u> | |
|---|---------------------------|-------------------|--------------------------|-------------------|
| | <u>Carrying Value</u> | <u>Fair Value</u> | <u>Carrying Value</u> | <u>Fair Value</u> |
| Long-term Borrowings: | | | | |
| 5.0% Exchangeable Senior Notes due March 2021 (Level 2) | \$ 81,247 | \$130,123 | \$ — | \$ — |
| 6.625% Senior Notes due July 2021 (Level 2) | \$221,647 | \$219,656 | \$221,082 | \$193,500 |

(In thousands of US dollars)

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On January 17, 2017, the Company's wholly-owned subsidiary, MagnaChip Semiconductor S.A., closed an offering (the "Exchangeable Notes Offering") of 5.0% Exchangeable Senior Notes due March 1, 2021 (the "Exchangeable Notes") of \$86,250 thousand, which represents the principal amount, excluding \$5,902 thousand of debt issuance costs. The Company estimates the fair value of the Exchangeable Notes using the market approach, which utilizes quoted market prices that fall under Level 2. For further description of the Exchangeable Notes, see Note 9, "Long-term Borrowings".

On July 18, 2013, the Company issued 6.625% senior notes due July 15, 2021 (the "2021 Notes") of \$225,000 thousand, which represents the principal amount, excluding \$1,125 thousand of original issue discount and \$5,120 thousand of debt issuance costs. The Company estimates the fair value of the 2021 Notes using the market approach, which utilizes quoted market prices that fall under Level 2. For further description of the 2021 Notes, see Note 9, "Long-term Borrowings".

Fair Values Measured on a Non-recurring Basis

The Company's non-financial assets, such as property, plant and equipment, and intangible assets, are recorded at fair value upon acquisition and are remeasured at fair value only if an impairment charge is recognized. As of September 30, 2017 and 2016, the Company did not have any assets or liabilities measured at fair value on a non-recurring basis.

[Table of Contents](#)**9. Long-Term Borrowings**

Long-term borrowings as of September 30, 2017 and December 31, 2016 are as follows (in thousands):

| | September 30, 2017 | December 31, 2016 |
|---|-----------------------|----------------------|
| 5.0% Exchangeable Senior Notes due March 2021 | \$ 86,250 | \$ — |
| 6.625% Senior Notes due July 2021 | \$ 225,000 | \$ 225,000 |
| Less: unamortized discount and debt issuance costs | (8,356) | (3,918) |
| Long-term borrowings, net of unamortized discount and debt issuance costs | <u>\$ 302,894</u> | <u>\$ 221,082</u> |

5.0% Exchangeable Senior Notes

On January 17, 2017, MagnaChip Semiconductor S.A. closed the Exchangeable Notes Offering of \$86,250 thousand aggregate principal amount of 5.0% Exchangeable Notes. Interest on the Exchangeable Notes accrues at a rate of 5.0% per annum, payable semi-annually on March 1 and September 1 of each year, beginning on March 1, 2017. The Exchangeable Notes will mature on March 1, 2021, unless earlier repurchased or converted. Holders may convert their notes at their option at any time prior to the close of business on the business day immediately preceding the stated maturity date.

The Company used a portion of the net proceeds from the issuance to repurchase 1,795,444 shares of common stock under its stock repurchase program at an aggregate cost of \$11,401 thousand.

Upon conversion, the Company will deliver for each \$1,000 principal amount of converted notes a number of shares equally to the exchange rate, which will initially be 121.1387 shares of common stock per \$1,000 principal amount of Exchangeable Notes, equivalent to an initial exchange price of approximately \$8.26 per share of common stock. The exchange rate will be subject to adjustment in some circumstances, but will not be adjusted for any accrued and unpaid interest. In addition, if a “make-whole fundamental change” (as defined in the Exchangeable Notes indenture (the “Exchangeable Notes Indenture”)) occurs prior to the stated maturity date, the Company will increase the exchange rate for a holder who elects to convert its notes in connection with such make-whole fundamental change in certain circumstances. MagnaChip Semiconductor S.A. may also, under certain circumstances, be required to pay additional amounts to holders of Exchangeable Notes if withholding or deduction is required in a relevant tax jurisdiction.

If the Company undergoes a fundamental change, subject to certain conditions, holders may require the Company to repurchase for cash all or part of their notes at a purchase price equal to 100% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest to, but excluding, the fundamental change purchase date. In addition, upon certain events of default described in the Exchangeable Notes Indenture, the trustee or holders of at least 25% principal amount of the Exchangeable Notes may declare 100% of the then outstanding Exchangeable Notes due and payable in full, together with all accrued and unpaid interest thereon. Payment of principal on the Exchangeable Notes may also accelerate and become automatically due and payable upon certain events of default involving bankruptcy or insolvency proceedings involving the Company, MagnaChip Semiconductor S.A. and their significant subsidiaries. The Exchangeable Notes are not redeemable at the option of MagnaChip Semiconductor S.A. prior to the maturity date.

The Exchangeable Notes Indenture contains covenants that limit the ability of the Company, MagnaChip Semiconductor S.A. and the Company’s other restricted subsidiaries to: (i) declare or pay any dividend or make any payment or distribution on account of or purchase or redeem the Company’s capital stock or equity interests of the restricted subsidiaries; (ii) make any principal payment on, or redeem or repurchase, prior to any scheduled repayment or maturity, any subordinated indebtedness; (iii) make certain investments; (iv) incur additional indebtedness and issue certain types of capital stock; (v) create or incur any lien (except for permitted liens) that secures obligations under any indebtedness; (vi) merge with or into or sell all or substantially all of the Company’s assets to other companies; (vii) enter into certain types of transactions with affiliates; (viii) guarantee the payment of any indebtedness; and (ix) designate unrestricted subsidiaries.

These covenants are subject to a number of exceptions and qualifications. Certain of these restrictive covenants will terminate if the Exchangeable Notes are rated investment grade at any time.

The Company incurred debt issuance costs of \$5,902 thousand related to the issuance of the Exchangeable Notes. The debt issuance costs are recorded as a direct deduction from the long-term borrowings in the consolidated balance sheets and amortized to interest expense using the effective interest method over the term of the Exchangeable Notes. Interest expense related to the Exchangeable Notes for the nine months ended September 30, 2017 was \$3,942 thousand.

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6.625% Senior Notes

On July 18, 2013, the Company issued \$225,000,000 aggregate principal amount of the 2021 Notes at a price of 99.5%. Interest on the 2021 Notes accrues at a rate of 6.625% per annum, payable semi-annually on January 15 and July 15 of each year, beginning on January 15, 2014.

The Company can optionally redeem all or a part of the 2021 Notes according to the following schedule: on or after July 15, 2017, the Company may on any one or more occasions redeem all or a part of the 2021 Notes, at a redemption price equal to 103.313%, 101.656% and 100% of the principal amount of the notes redeemed on or after July 15, 2017, 2018 and 2019, respectively, plus accrued and unpaid interest and special interest, if any, on the notes redeemed, to the applicable date of redemption.

The Indenture relating to the 2021 Notes contains covenants that limit the ability of the Company and its restricted subsidiaries to: (i) declare or pay any dividend or make any payment or distribution on account of or purchase or redeem the Company's capital stock or equity interests of the restricted subsidiaries; (ii) make any principal payment on, or redeem or repurchase, prior to any scheduled repayment or maturity, any subordinated indebtedness; (iii) make certain investments; (iv) incur additional indebtedness and issue certain types of capital stock; (v) create or incur any lien (except for permitted liens) that secures obligations under any indebtedness; (vi) merge with or into or sell all or substantially all of the Company's assets to other companies; (vii) enter into certain types of transactions with affiliates; (viii) guarantee the payment of any indebtedness; (ix) enter into sale-leaseback transactions; (x) enter into agreements that would restrict the ability of the restricted subsidiaries to make distributions with respect to their equity to the Company or other restricted subsidiaries, to make loans to the Company or other restricted subsidiaries or to transfer assets to the Company or other restricted subsidiaries; and (xi) designate unrestricted subsidiaries.

These covenants are subject to a number of exceptions and qualifications. Certain of these restrictive covenants will terminate if the 2021 Notes are rated investment grade at any time.

The Company incurred original issue discount of \$1,125 thousand and debt issuance costs of \$5,120 thousand related to the issuance of the 2021 Notes. The original issue discount and the debt issuance costs are recorded as a direct deduction from the long-term borrowings in the consolidated balance sheets and amortized to interest expense using the effective interest method over the term of the 2021 Notes. Interest expenses related to the 2021 Notes for the nine months ended September 30, 2017 and 2016 were \$11,744 thousand and \$11,706 thousand, respectively.

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10. Accrued Severance Benefits

The majority of accrued severance benefits are for employees in the Company's Korean subsidiary. Pursuant to the Employee Retirement Benefit Security Act of Korea, eligible 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 September 30, 2017, 98% of employees of the Company were eligible for severance benefits.

Changes in accrued severance benefits are as follows (in thousands):

| | Three Months Ended | Nine Months Ended | Three Months Ended | Nine Months Ended |
|---|--------------------------|-------------------------|--------------------------|-------------------------|
| | September 30, 2017 | | September 30, 2016 | |
| Beginning balance | \$130,894 | \$130,144 | \$132,800 | \$135,160 |
| Provisions | 4,578 | 15,354 | 3,782 | 13,609 |
| Severance payments | (1,496) | (19,578) | (1,076) | (14,178) |
| Translation adjustments | (852) | 7,204 | 8,350 | 9,265 |
| | <u>133,124</u> | <u>133,124</u> | <u>143,856</u> | <u>143,856</u> |
| Less: Cumulative contributions to the National Pension Fund | (243) | (243) | (305) | (305) |
| Group severance insurance plan | (593) | (593) | (705) | (705) |
| Accrued severance benefits, net | <u>\$132,288</u> | <u>\$132,288</u> | <u>\$142,846</u> | <u>\$142,846</u> |

The severance benefits funded through the Company's National Pension Fund and group severance insurance plan will be used exclusively for payment of severance benefits to eligible employees. These amounts have been deducted from the accrued severance benefit balance.

The Company is liable to pay the following future benefits to its non-executive employees upon their normal retirement age (in thousands):

| | Severance benefit |
|-------------------|-------------------|
| Remainder of 2017 | \$ — |
| 2018 | — |
| 2019 | 537 |
| 2020 | 1,004 |
| 2021 | 1,439 |
| 2022 | 1,407 |
| 2023 – 2027 | 19,016 |

The above amounts were determined based on the non-executive 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 non-executive employees that will cease working with the Company before their normal retirement ages.

Korea's mandatory retirement age is 60 under the Employment Promotion for the Aged Act.

11. Foreign Currency Gain, Net

Net foreign currency gain or loss includes non-cash translation gain or loss associated with intercompany balances. A substantial portion of the Company's net foreign currency gain or loss is non-cash translation gain or loss associated with intercompany long-term loans to the Company's Korean subsidiary. The loans are denominated in U.S. dollars and are affected by changes in the exchange rate between the Korean won and the U.S. dollar. As of September 30, 2017, the outstanding intercompany loan balance including accrued interests between the Korean subsidiary and the Dutch subsidiary was \$669,637 thousand. This amount includes a newly executed intercompany loan of \$75,000 thousand during the first quarter of 2017, which was used to transfer a portion of the net proceeds from the Exchangeable Notes Offering from the Company's Luxembourg's subsidiary to its Dutch subsidiary, and then to the Korean subsidiary. The Korean won to U.S. dollar exchange rates were 1,146.7:1 and 1,208.5:1 using the first base rate as of September 30, 2017 and December 31, 2016, respectively, as quoted by the KEB Hana Bank.

12. Restructuring and Other Charges (Gain), Net

As of December 21, 2016, the Company entered into a purchase and sale agreement to sell a building located in Cheongju, South Korea. The building has historically been used to house the Company's six-inch fabrication facility in Cheongju, South Korea (the "6-inch fab") and became vacant upon the closure of the fabrication facility in February 2016. As of December 31, 2015, the building was fully impaired. The Company received proceeds of \$18,204 thousand, including a \$1,655 thousand value-added tax, for the sale of the building in December 2016. As the Company was obligated to perform certain removal construction work, it recorded the \$18,204 thousand proceeds as restricted cash and \$16,549 thousand as deposits received in its consolidated balance sheets as of December 31, 2016. During the first quarter of 2017, the Company completed all removal construction work necessary to transfer the title of the building, and the \$18,204 thousand of restricted cash was fully released. Accordingly, the Company recorded \$16,635 thousand as restructuring gain in the consolidated statements of operations for the three months ended March 31, 2017.

In March 2017, the Company sold its sensor product business, which was included in and reported as part of Display Solutions line of its Standard Products Group, to a third party for proceeds of \$1,295 thousand, in an effort to improve our overall profitability. The Company recorded \$375 thousand net gain from this sale after deducting the book values of certain assets transferred to the buyer.

During the first quarter of 2016, the Company completed all procedures necessary to sell all machinery in its closed 6-inch fab and recognized the \$7,785 thousand of restructuring gain from the related deposit of \$8,165 thousand received as of December 31, 2015, net of certain direct selling costs.

13. Early Termination Charges

As of February 22, 2017, the Company's Board of Directors approved the implementation of a new headcount reduction plan (the "Headcount Reduction Plan"). As of June 30, 2017, 352 employees elected to resign from the Company during the period in which the Headcount Reduction Plan was offered. The total cash cost of approximately \$31 million has been fully paid. The Company recorded in its consolidated statement of operations \$11.1 million and \$2.3 million in termination related charges as early termination charges for the three months ended March 31, 2017 and June 30, 2017, respectively. The remaining total estimated cost relates to statutory severance benefits, which are required by law and have already been fully accrued in the Company's financial statements.

14. Income Taxes

The Company files income tax returns in the U.S., Korea, Japan, Taiwan and various other jurisdictions. The Company is subject to income- or non-income-based tax examinations by tax authorities of the U.S., Korea and multiple other foreign jurisdictions, where applicable, for all open tax years.

The Company's Korean subsidiary is the primary operating subsidiary of the Company. For the nine months ended September 30, 2017 and 2016, no income tax expense or benefit for the Korean subsidiary was recorded due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets.

Income tax expense recorded for the nine months ended September 30, 2017 and 2016 was \$2,328 thousand and \$1,845 thousand, respectively. The increase in income tax expenses was primarily attributable to changes in unrecognized tax benefits as a result of a lapse of the applicable statute of limitations in the Korean subsidiary and an increase in accrued interests on intercompany loans.

In September 2017, the Company's Korean subsidiary was notified that the Korean National Tax Service would be examining the income- and non-income-based taxes for the Company's Korean subsidiary for its 2012 to 2014 tax years. The Company cannot currently reasonably anticipate the results of such examinations.

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15. Geographic and Segment Information

The Company has two operating segments: Foundry Services Group and Standard Products Group. The Company's chief operating decision maker is its Chief Executive Officer who allocates resources and assesses performance of the business and other activities based on gross profit.

The following sets forth information relating to the operating segment (in thousands):

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------|--------------------|--------------------|--------------------|--------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Net Sales | | | | |
| Foundry Services Group | \$ 80,404 | \$ 73,863 | \$ 239,460 | \$ 196,152 |
| Standard Products Group | | | | |
| Display Solutions | 57,236 | 84,706 | 155,868 | 217,171 |
| Power Solutions | 39,001 | 33,619 | 109,595 | 93,750 |
| Total Standard Products Group | 96,237 | 118,325 | 265,463 | 310,921 |
| All other | 56 | 108 | 169 | 434 |
| Total net sales | <u>\$ 176,697</u> | <u>\$ 192,296</u> | <u>\$ 505,092</u> | <u>\$ 507,507</u> |
| | | | | |
| | Three Months Ended | | Nine Months Ended | |
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Gross Profit | | | | |
| Foundry Services Group | \$ 24,374 | \$ 17,340 | \$ 69,894 | \$ 45,820 |
| Standard Products Group | 25,880 | 21,691 | 68,479 | 64,836 |
| All other | 56 | 108 | 169 | (519) |
| Total gross profit | <u>\$ 50,310</u> | <u>\$ 39,139</u> | <u>\$ 138,542</u> | <u>\$ 110,137</u> |

The following is a summary of net sales by geographic region, based on the location to which the products are billed (in thousands):

| | Three Months Ended | |
|---------------------------------|--------------------|--------------------|
| | September 30, 2017 | September 30, 2016 |
| Korea | \$ 74,327 | \$ 58,521 |
| Asia Pacific (other than Korea) | 83,221 | 107,551 |
| U.S.A. | 8,399 | 15,396 |
| Europe | 10,492 | 10,497 |
| Others | 258 | 331 |
| Total | <u>\$ 176,697</u> | <u>\$ 192,296</u> |
| | | |
| | Nine Months Ended | |
| | September 30, 2017 | September 30, 2016 |
| Korea | \$ 207,389 | \$ 155,971 |
| Asia Pacific (other than Korea) | 239,209 | 289,451 |
| U.S.A. | 28,721 | 28,510 |
| Europe | 29,070 | 32,763 |
| Others | 703 | 812 |
| Total | <u>\$ 505,092</u> | <u>\$ 507,507</u> |

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Net sales from the Company's top ten largest customers accounted for 58% and 69% for the three months ended September 30, 2017 and 2016, respectively, and 59% and 65% for the nine months ended September 30, 2017 and 2016, respectively.

For the three months ended September 30, 2017, the Company had one customer that represented 16.9% of its net sales, and for the nine months ended September 30, 2017, the Company had one customer that represented 15.6% of its net sales.

For the three months ended September 30, 2016, the Company had two customers that represented 27.8% and 11.2% of its net sales, respectively, and for the nine months ended September 30, 2016, the Company had two customers that represented 25.6% and 11.1% of its net sales, respectively.

97% of the Company's property, plant and equipment are located in Korea as of September 30, 2017.

16. Accumulated Other Comprehensive Income (Loss)

Accumulated other comprehensive income (loss) consists of the following as of September 30, 2017 and December 31, 2016, respectively (in thousands):

| | September 30, 2017 | December 31, 2016 |
|--|-----------------------|----------------------|
| Foreign currency translation adjustments | \$ (8,810) | \$ 14,460 |
| Derivative adjustments | (1,067) | (436) |
| Total | <u>\$ (9,877)</u> | <u>\$ 14,024</u> |

Changes in accumulated other comprehensive income (loss) for the three months ended September 30, 2017 and 2016 are as follows (in thousands):

| | Foreign currency translation adjustments | Derivative adjustments | Total |
|--|---|---------------------------|-------------------|
| Three Months Ended September 30, 2017 | | | |
| Beginning balance | \$ (11,502) | \$ (832) | \$(12,334) |
| Other comprehensive income (loss) before reclassifications | 2,692 | (193) | 2,499 |
| Amounts reclassified from accumulated other comprehensive income | — | (42) | (42) |
| Net current-period other comprehensive income (loss) | 2,692 | (235) | 2,457 |
| Ending balance | <u>\$ (8,810)</u> | <u>\$ (1,067)</u> | <u>\$ (9,877)</u> |
| Three Months Ended September 30, 2016 | | | |
| Beginning balance | \$ (43) | \$ — | \$ (43) |
| Other comprehensive loss before reclassifications | (27,340) | (83) | (27,423) |
| Amounts reclassified from accumulated other comprehensive income | — | — | — |
| Net current-period other comprehensive loss | (27,340) | (83) | (27,423) |
| Ending balance | <u>\$ (27,383)</u> | <u>\$ (83)</u> | <u>\$(27,466)</u> |

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Changes in accumulated other comprehensive income (loss) for the nine months ended September 30, 2017 and 2016 are as follows (in thousands):

| | Foreign currency translation adjustments | Derivative adjustments | Total |
|--|---|-----------------------------------|--------------------|
| Nine Months Ended September 30, 2017 | | | |
| Beginning balance | \$ 14,460 | \$ (436) | \$ 14,024 |
| Other comprehensive income (loss) before reclassifications | (23,270) | 716 | (22,554) |
| Amounts reclassified from accumulated other comprehensive income | — | (1,347) | (1,347) |
| Net current-period other comprehensive loss | (23,270) | (631) | (23,901) |
| Ending balance | <u>\$ (8,810)</u> | <u>\$ (1,067)</u> | <u>\$ (9,877)</u> |
| | | | |
| | Foreign currency translation adjustments | Derivative adjustments | Total |
| Nine Months Ended September 30, 2016 | | | |
| Beginning balance | \$ (190) | \$ (41) | \$ (231) |
| Other comprehensive loss before reclassifications | (27,193) | (42) | (27,235) |
| Amounts reclassified from accumulated other comprehensive income | — | — | — |
| Net current-period other comprehensive loss | (27,193) | (42) | (27,235) |
| Ending balance | <u>\$ (27,383)</u> | <u>\$ (83)</u> | <u>\$ (27,466)</u> |

There was no income tax impact related to changes in accumulated other comprehensive income (loss) for the three and nine months ended September 30, 2017 and 2016 due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets.

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17. Earnings per Share

The following table illustrates the computation of basic and diluted earnings per common share for the three and nine months ended September 30, 2017 and 2016:

| | Three Months Ended | |
|---|--|-------------------------------|
| | September 30, 2017 | September 30, 2016 |
| | (In thousands of US dollars, except share data) | |
| Basic Earnings per Share | | |
| Net income | \$ 5,604 | \$ 29,866 |
| Basic weighted average common stock outstanding | 34,103,029 | 34,849,805 |
| Basic earnings per share | \$ 0.16 | \$ 0.86 |
| Diluted Earnings per Share | | |
| Net income | \$ 5,604 | \$ 29,866 |
| Add back: Interest expense on Exchangeable Notes | 1,400 | — |
| Net income allocated to common stockholders | \$ 7,004 | \$ 29,866 |
| Basic weighted average common stock outstanding | 34,103,029 | 34,849,805 |
| Net effect of dilutive equity awards | 991,176 | 452,901 |
| Net effect of assumed conversion of 5.0% Exchangeable Notes to common stock | 10,448,213 | — |
| Diluted weighted average common stock outstanding | 45,542,418 | 35,302,706 |
| Diluted earnings per share | \$ 0.15 | \$ 0.85 |

| | Nine Months Ended | |
|---|--|-------------------------------|
| | September 30, 2017 | September 30, 2016 |
| | (In thousands of US dollars, except share data) | |
| Basic Earnings per Share | | |
| Net income | \$ 41,283 | \$ 20,175 |
| Basic weighted average common stock outstanding | 33,907,581 | 34,755,276 |
| Basic earnings per share | \$ 1.22 | \$ 0.58 |
| Diluted Earnings per Share | | |
| Net income | \$ 41,283 | \$ 20,175 |
| Add back: Interest expense on Exchangeable Notes | 3,942 | — |
| Net income allocated to common stockholders | \$ 45,225 | \$ 20,175 |
| Basic weighted average common stock outstanding | 33,907,581 | 34,755,276 |
| Net effect of dilutive equity awards | 695,427 | 322,039 |
| Net effect of assumed conversion of 5.0% Exchangeable Notes to common stock | 9,835,863 | — |
| Diluted weighted average common stock outstanding | 44,438,871 | 35,077,315 |
| Diluted earnings per share | \$ 1.02 | \$ 0.58 |

The following outstanding instruments were excluded from the computation of diluted earnings per share, as they have an anti-dilutive effect on the calculation:

| | Three Months Ended | | Nine Months Ended | |
|------------------------|-------------------------------|-------------------------------|-------------------------------|-------------------------------|
| | September 30, 2017 | September 30, 2016 | September 30, 2017 | September 30, 2016 |
| Options | 809,417 | 2,457,955 | 860,572 | 3,545,576 |
| Restricted Stock Units | — | — | — | — |

18. Commitments and Contingencies

SEC Enforcement Staff Review

In March 2014, the Company voluntarily reported to the Securities and Exchange Commission, or the SEC, that the Company's Audit Committee had determined that the Company incorrectly recognized revenue on certain transactions and as a result would restate its financial statements, and that the Audit Committee had commenced an independent investigation. Over the course of 2014 and the first two quarters of 2015, the Company voluntarily produced documents to the SEC regarding the various accounting issues identified during the independent investigation, and whether the Company's hiring of an accountant from the Company's independent registered public accounting firm impacted that accounting firm's independence. On July 22, 2014, the Staff of the SEC's Division of Enforcement obtained a Formal Order of Investigation. On March 12, 2015, the SEC issued a subpoena for documents to the Company in connection with its investigation. On May 1, 2017, the SEC announced that it had reached a final settlement with the Company, resolving SEC's investigation. In that connection, the Company has consented, without admitting or denying the SEC's findings, to the entry of an administrative order by the SEC directing that the Company cease and desist from committing or causing any violations of certain provisions of the federal securities laws and related SEC regulations. The SEC's administrative order was entered on May 1, 2017. The SEC imposed a monetary penalty of \$3,000 thousand on the Company. In the first quarter ended March 31, 2017, the Company established a reserve in that amount for the potential settlement of this matter. The reserved monetary penalty of \$3,000 thousand was paid to the SEC during the second quarter of 2017. The Company also agreed to an undertaking to cooperate fully with the SEC in any and all investigations, litigations or other proceedings relating to or arising from the matters described in the SEC's order. In connection with the settlement, the SEC considered remedial acts promptly undertaken by the Company and its cooperation with the SEC staff during the course of the investigation. Among other things, as previously disclosed in the Company's filings with the SEC, the Audit Committee of the Company self-investigated and self-reported the accounting errors, selected new management and implemented various additional controls designed to prevent similar errors going forward.

Securities Class Action Complaints

The Company recorded the \$23,500 thousand of the settlement obligation for the Class Action Litigation as accrued expenses in the consolidated balance sheets as of December 31, 2015 and as selling, general and administrative expenses in the consolidated statements of operations for the year ended December 31, 2015. For further information regarding the Class Action Litigation, see "Part I: Item 3. Legal Proceedings" included elsewhere in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2016 (the "2016 Form 10-K"). The Company recorded \$29,571 thousand of the proceeds from the insurers as other receivables in the consolidated balance sheets as of December 31, 2015 and as a deduction of the selling, general and administrative expenses in the consolidated statements of operations for the year ended December 31, 2015. The proceeds from the insurers of \$29,571 thousand were deposited into the Company's escrow account during the first quarter of 2016 and the Company reclassified the \$29,571 thousand deposits recorded in other receivables into restricted cash. During the third quarter of 2016, the Company disbursed the aggregate settlement payment of \$23,500 thousand after the court granted plaintiffs' renewed motion for preliminary approval of the settlement in July 2016. Upon the settlement payment, \$6,114 thousand of the insurance proceeds remained in the Company's escrow account. For subsequent treatment of the escrow amount, see "*Shareholder Derivative Complaints*" below.

Shareholder Derivative Complaints

The settlement for the shareholder derivative actions described in "Part I: Item 3. Legal Proceedings" of the 2016 Form 10-K provided for an aggregate payment from the Company defendants' directors and officers insurance policies of \$3,000 thousand to be made to an escrow account, which will be payable to the Company (less certain deductions and applicable interest) once the settlement becomes effective. For further information regarding the shareholder derivative actions, see "Part I: Item 3. Legal Proceedings" in the 2016 Form 10-K. The \$3,000 thousand settlement payment was included in the insurance proceeds of \$29,571 thousand as discussed in "*Securities Class Action Complaints*" above.

On June 10, 2016, the court granted plaintiffs' motion for preliminary approval of the proposed settlement. On October 18, 2016, after a hearing held on October 14, 2016, the court entered its order and final judgment (the "Judgment") granting final approval of the proposed settlement and awarding plaintiffs' counsel \$750 thousand for attorneys' fees and litigation expenses. As a result, \$750 thousand was paid out of the Company's escrow account. The Judgment was not appealed within the applicable appeals period (on or before December 19, 2016). The settlement therefore became effective after the expiration of the appeals period and \$2,258 thousand was paid to the Company from the escrow account, previously recorded as restricted cash, in December 2016. The remaining restricted cash related to insurance proceeds of \$3,078 thousand was also released in December 2016.

FORWARD LOOKING STATEMENTS

The following Management’s Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended (the “Exchange Act”), and Section 27A of the Securities Act of 1933, as amended, that involve risks and uncertainties. Forward-looking statements give our current expectations and projections relating to our financial condition, results of operations, plans, objectives, future performance and business. You can identify these statements by the fact that they do not relate strictly to historical or current facts. These statements may include words such as “anticipate,” “estimate,” “expect,” “project,” “intend,” “plan,” “believe” and other words and terms of similar meaning in connection with any discussion of the timing or nature of future operating or financial performance or other events. All statements other than statements of historical facts included in this report that address activities, events or developments that we expect, believe or anticipate will or may occur in the future are forward-looking statements.

These forward-looking statements are largely based on our expectations and beliefs concerning future events, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Although we believe our estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management’s assumptions about future events may prove to be inaccurate. Management cautions all readers that the forward-looking statements contained in this report are not guarantees of future performance, and we cannot assure any reader that those statements will be realized or the forward-looking events and circumstances will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to the factors listed in this section, in “Part II: Item 1A. Risk Factors” herein and in “Part I: Item 1A. Risk Factors” in our 2016 Form 10-K.

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

Statements made in this Quarterly Report on Form 10-Q (this “Report”), unless the context otherwise requires, that include the use of the terms “we,” “us,” “our” and “MagnaChip” refer to MagnaChip Semiconductor Corporation and its consolidated subsidiaries. The term “Korea” refers to the Republic of Korea or South Korea.

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

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and the related notes included elsewhere in this Report.

Overview

We are a designer and manufacturer of analog and mixed-signal semiconductor platform solutions for communications, IoT, consumer, industrial and automotive applications. We provide technology platforms for analog, mixed-signal, power, high voltage, non-volatile memory, and RF applications. We have a proven record with over 30 years of operating history, a portfolio of approximately 3,300 registered patents and pending applications and extensive engineering and manufacturing process expertise.

Our Foundry Services Group provides specialty analog and mixed-signal foundry services mainly for fabless and IDM semiconductor companies that primarily serve communications, IoT, consumer, industrial and automotive applications. Our Standard Products Group includes our Display Solutions and Power Solutions business lines. Our Display Solutions products provide panel display solutions to major suppliers of large and small rigid and flexible panel displays, and mobile, automotive applications and home appliances. Our Power Solutions products include discrete and integrated circuit solutions for power management in communications, consumer and industrial applications.

Our wide variety of analog and mixed-signal semiconductor products and manufacturing services combined with our mature technology platform allow us to address multiple high-growth end markets and to rapidly develop and introduce new products and services in response to market demands. Our design center and substantial manufacturing operations in Korea place us at the core of the global electronics device supply chain. We believe this enables us to quickly and efficiently respond to our customers’ needs and allows us to better serve and capture additional demand from existing and new customers.

To maintain and increase our profitability, we must accurately forecast trends in demand for electronics devices that incorporate semiconductor products we produce. We must understand our customers’ needs as well as the likely end market trends and demand in the markets they serve. We must balance the likely manufacturing utilization demand of our product businesses and foundry business to optimize our capacity utilization. We must also invest in relevant research and development activities and manufacturing capacity and purchase necessary materials on a timely basis to meet our customers’ demand while maintaining our target margins and cash flow.

The semiconductor markets in which we participate are highly competitive. The prices of our products tend to decrease regularly over their useful lives, and such price decreases can be significant as new generations of products are introduced by us or our competitors. We strive to offset the impact of declining selling prices for existing products through cost reductions and the introduction of new products that command selling prices above the average selling price of our existing products. In addition, we seek to manage our inventories and manufacturing capacity so as to mitigate the risk of losses from product obsolescence.

Demand for our products and services is driven by overall demand for communications, IoT, consumer, industrial and automotive products and can be adversely affected by periods of weak consumer and enterprise spending or by market share losses by our customers. In order to mitigate the impact of market volatility on our business, we are diversifying our portfolio of products, customers, and target applications. We also expect that new competitors will emerge in these markets that may place increased pressure on the pricing for our products and services. While we believe we are well positioned competitively to compete in these markets and against these new competitors as a result of our long operating history, existing manufacturing capacity and our Korea-based operations, if we are not effective in competing in these markets our operating results may be adversely affected.

Within our Foundry Services Group, net sales are driven by customers’ decisions on which manufacturing services provider to use for a particular product. Most of our Foundry Services Group customers are fabless, while some are IDM customers. A customer will often have more than one supplier of manufacturing services. In any given period, our net sales depend heavily upon the end-market demand for the goods in which the products we manufacture for customers are used, the inventory levels maintained by our customers and in some cases, allocation of demand for manufacturing services among selected qualified suppliers.

Within our Standard Products Group, net sales are driven by design wins in which we are selected by an electronics original equipment manufacturer (OEM) or other potential customer to supply its demand for a particular product. A customer will often have more than one supplier designed in to multi-source components for a particular product line. Once we have design wins and the products enter into mass production, we often specify the pricing of a particular product for a set period of time, with periodic discussions and renegotiations of pricing with our customers. In any given period, our net sales depend heavily upon the end-market demand for the goods in which our products are used, the inventory levels maintained by our customers and in some cases, allocation of demand for components for a particular product among selected qualified suppliers.

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In contrast to completely fabless semiconductor companies, our internal manufacturing capacity provides us with greater control over manufacturing costs and the ability to implement process and production improvements for our internally manufactured products, which can favorably impact gross profit margins. Our internal manufacturing capacity also allows for better control over delivery schedules, improved consistency over product quality and reliability and improved ability to protect intellectual property from misappropriation on these products. However, having internal manufacturing capacity exposes us to the risk of under-utilization of manufacturing capacity that results in lower gross profit margins, particularly during downturns in the semiconductor industry.

Our products and services require investments in capital equipment. Analog and mixed-signal manufacturing facilities and processes are typically distinguished by the design and process implementation expertise rather than the use of the most advanced equipment. Many of these processes also tend to migrate more slowly to smaller geometries due to technological barriers and increased costs. For example, some of our products use high-voltage technology that requires larger geometries and that may not migrate to smaller geometries for several years, if at all. As a result, our manufacturing base and strategy do not require substantial investment in leading edge process equipment for those products, allowing us to utilize our facilities and equipment over an extended period of time with moderate required capital investments. In general, we seek to invest in manufacturing capacity that can be used for multiple high-value applications over an extended period of time. In addition, we outsource manufacturing of those products which do require advanced technology and 12-inch wafer capacity. We believe this capital investment strategy enables us to optimize our capital investments and facilitates more diversified product and service offerings.

Since 2007, we have designed and manufactured organic light emitting diodes (OLED) display driver ICs in our internal manufacturing facilities. As we expanded our design capabilities to products that require lower geometries unavailable at our existing manufacturing facilities, we began outsourcing manufacturing of certain OLED display driver ICs to an external foundry from the second half of 2015. This additional source of manufacturing is an increasingly important part of our supply chain management. By outsourcing manufacturing of advanced OLED products to external foundries, we are able to dynamically adapt to the changing customer requirements and address growing markets without substantial capital investments by us. Both at the internal manufacturing facilities and external foundries, we apply our unique OLED process patents as well as other intellectual property, proprietary process design kits and custom design-flow methodologies.

In our previous public filings, we had used a term “active matrix organic light emitting diodes (AMOLED)” that described a display technology used in certain display driver ICs that we had designed and manufactured in our internal and external foundries. Beginning in the second quarter of 2017, we have used the term “OLED” instead of the term “AMOLED” in our public filings in order to be consistent with commonly accepted industry naming practices for this product category. There is no change to the products that we previously referred to as AMOLED display driver ICs.

Our success going forward will depend upon our ability to adapt to future challenges such as the emergence of new competitors for our products and services or the consolidation of current competitors. Additionally, we must innovate to remain ahead of, or at least rapidly adapt to, technological breakthroughs that may lead to a significant change in the technology necessary to deliver our products and services. We believe that our established relationships and close collaboration with leading customers enhance our awareness of new product opportunities, market and technology trends and improve our ability to adapt and grow successfully. In our Foundry Services Group, we strive to maintain competitiveness by offering high-value added processes, high-flexibility and excellent service by tailoring existing standard processes to meet customers’ design needs and porting customers’ own process technologies into our fabrication facilities.

Recent Developments

Secondary offering

On August 15, 2017, certain of our stockholders that are affiliates of Avenue Capital Management II, L.P. (the “Selling Stockholders”) closed an underwritten registered public offering of 4,088,978 shares of our common stock at a price per share of \$11.10. We did not receive any proceeds from the sale of our common stock by the Selling Stockholders, but paid certain expenses in connection with such secondary offering pursuant to an existing contractual arrangement with the Selling Stockholders.

Events associated with the closure of our 6-inch fab and reduction of workforce

In December 2014, we announced that our Board of Directors had adopted a plan to close our 6-inch fab. During the fourth quarter of 2015, we received an \$8.2 million deposit for sale of machinery in conjunction with the planned closure of our 6-inch fab. According to this plan, the 6-inch fab was closed on February 29, 2016. During the first quarter of 2016, we completed all procedures necessary to sell all machineries in our closed 6-inch fab and recognized a \$7.8 million restructuring gain from the related deposit of \$8.2 million, net of certain direct selling costs. On April 4, 2016, we commenced a voluntary resignation program (the "Program"), which was available to certain manufacturing employees, including our 6-inch fab employees, through April 29, 2016.

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As of April 29, 2016, 169 employees elected to resign under the terms of the Program, from which we expect to save approximately \$8 million in spending per year. We paid approximately \$8 million for severance benefits, which are required by law and had already been fully accrued in our financial statements, in a lump sum during the second quarter of 2016. Beginning in May 2016, we also began to pay a portion of the \$4.2 million other termination benefits under the Program, which were paid in equal monthly installments over twelve months. We recorded the \$4.2 million charge related to the full amount of these other termination benefits payable under the Program during the second quarter of 2016.

As of December 21, 2016, we entered into a purchase and sale agreement to sell a building located in Cheongju, South Korea. The building has historically been used to house the 6-inch fab and became vacant upon the closure of the fabrication facility. As of December 31, 2015, the building was fully impaired. We received proceeds of \$18.2 million, including a \$1.7 million value-added tax, for the sale of the building on December 26, 2016. We recorded the \$18.2 million as restricted cash in our consolidated balance sheets as of December 31, 2016 as we were obligated to perform certain removal construction work that was expected to be completed by the end of March 2017. During the first quarter of 2017, we completed all removal construction work necessary to transfer the title of the building, and the \$18.2 million of restricted cash was fully released.

As of February 22, 2017, our Board of Directors approved the implementation of the Headcount Reduction Plan. As of June 30, 2017, 352 employees elected to resign from the Company during the period in which the Headcount Reduction Plan was offered. The Headcount Reduction Plan is expected to result in estimated annual cost savings of approximately \$24 million. The total cash cost of approximately \$31 million has been fully paid. We recorded in the consolidated statement of operations \$11.1 million and \$2.3 million termination related charges as “early termination charges” for the three months ended March 31, 2017 and June 30, 2017, respectively. The remaining total cost relates to statutory severance benefits, which are required by law and have already been fully accrued in our financial statements.

Issuance of Exchangeable Senior Notes and Stock Repurchase

As of January 17, 2017, we closed the offering (the “Exchangeable Notes Offering”) by our Luxembourg subsidiary, MagnaChip Semiconductor S.A., of \$86.25 million aggregate principal amount of its 5.00% Exchangeable Senior Notes due 2021 (the “Exchangeable Notes”), reflecting the full exercise of the initial purchasers’ option to purchase additional Exchangeable Notes. We used a portion of the net proceeds from the Exchangeable Notes Offering to repurchase 1,795,444 shares of our common stock under our stock repurchase program, which was authorized by our board of directors on January 10, 2017, at an aggregate cost of \$11.4 million.

Sale of Sensor Business

In March 2017, we sold our sensor product business, which was included in and reported as part of the Display Solutions line of our Standard Products Group, to a third party for proceeds of \$1.3 million, in an effort to improving our overall profitability. We recorded a \$0.4 million gain from this sale after deducting the book values of certain assets transferred to the buyer.

Restatement

In January 2014, our Audit Committee commenced an independent investigation that resulted in the restatement of certain financial statements for prior periods. In March, 2014, we voluntarily reported to the SEC that our Audit Committee had determined that we incorrectly recognized revenue on certain transactions and as a result would restate our financial statements, and that our Audit Committee had commenced an independent investigation.

On December 10, 2015, we entered into a Memorandum of Understanding with the plaintiffs’ representatives to settle the Class Action Litigation, as defined and detailed in “Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements—Note 18. Commitments and Contingencies” in this Report, for an aggregate settlement payment of \$23.5 million. This settlement payment was fully funded by insurance proceeds that were received in the first quarter of 2016 and disbursed from the escrow account, previously recorded as restricted cash, in the third quarter of 2016.

On January 22, 2016, we entered into a stipulation of settlement with the plaintiffs in the shareholder derivative actions, as described in “Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements—Note 18. Commitments and Contingencies” in this Report, for an aggregate payment of \$3.0 million from our insurance proceeds that were received in the first quarter of 2016 and recorded in the escrow account. In October 2016, the court approved the settlement of the shareholder derivative actions for \$3.0 million, which included \$0.75 million awarded to plaintiffs’ counsel. Upon the expiration of the appeals period, \$2.25 million was disbursed from the escrow account, previously recorded as restricted cash, in December 2016. The remaining restricted cash related to insurance proceeds of \$3.1 million was also released in December 2016.

On May 1, 2017, the SEC announced that it had reached a final settlement with us, resolving the SEC’s investigation, as detailed in “Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements— Note 18. Commitments and Contingencies” in this Report. In that connection, we have consented, without admitting or denying the SEC’s findings, to the entry of an administrative order by the SEC directing that we cease and desist from committing or causing any violations of certain provisions of the federal securities laws and related SEC regulations. The SEC’s administrative order was entered on May 1, 2017. The SEC

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imposed a monetary penalty of \$3.0 million on us. In the first quarter ended March 31, 2017, we established a reserve in that amount for the potential settlement of this matter and recorded it as selling, general and administrative expense in the consolidated statements of operations for the three months ended March 31, 2017. The reserved monetary penalty of \$3.0 million was paid to the SEC during the second quarter of 2017.

As a result of the restatement, we have incurred substantial external accounting, legal and other related costs associated with the restatement and certain litigation and other regulatory investigations and actions related thereto. We recorded restatement related costs of \$6.0 million for the nine months ended September 30, 2017, compared to \$6.4 million for the nine months ended September 30, 2016.

Segments

We report our financial results in two operating segments: Foundry Services Group and Standard Products Group. We identified these segments based on how we allocate resources and assess our performance.

- **Foundry Services Group:** Our Foundry Services Group provides specialty analog and mixed-signal foundry services to fabless semiconductor companies and IDMs that serve communications, IoT, consumer, industrial and automotive applications. We manufacture wafers based on our customers' product designs. We do not market these products directly to end customers but rather supply manufactured wafers and products to our customers to market to their end customers. We offer approximately 502 process flows to our foundry services customers. We also often partner with key customers to jointly develop or customize specialized processes that enable our customers to improve their products and allow us to develop unique manufacturing expertise. Our foundry services target customers who require differentiated, specialty analog and mixed-signal process technologies such as high voltage complementary metal-oxide-semiconductor (CMOS), non-volatile memory or bipolar-CMOS-DMOS (BCD). These customers typically serve communications, IoT, consumer, industrial and automotive applications. Our Foundry Services Group business represented 47.4% and 38.7% of our net sales for the nine months ended September 30, 2017 and September 30, 2016, respectively. Gross profit from our Foundry Services Group business was \$69.9 million and \$45.8 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.
- **Standard Products Group:** Our Standard Products Group includes our Display Solutions and Power Solutions business lines. Our Display Solutions products include source, gate drivers, timing controllers, and one-chip integrated solutions that cover a wide range of panel displays used in ultra high definition (UHD), high definition (HD), light emitting diode (LED), 3D and OLED televisions public displays, notebooks, mobile communications, entertainment devices and automotive applications. Our Display Solutions products support the industry's most advanced display technologies, such as OLEDs, and low temperature polysilicons (LTPS), as well as high-volume display technologies such as thin film transistors (TFT). Since 2007, we have designed and manufactured OLED display driver IC products. Our current portfolio of OLED solutions address a wide range of resolutions ranging from HD to Wide Quad High Definition (WQHD) for applications including smartphones, TVs, and other mobile devices. We believe we have a unique intellectual property portfolio and mixed-signal design and manufacturing expertise in the OLED industry. Our Power Solutions business line produces power management semiconductor products including discrete and integrated circuit solutions for power management in high-volume consumer applications. These products include metal oxide semiconductor field effect transistors (MOSFETs), insulated-gate bipolar transistors (IGBTs), AC-DC converters, DC-DC converters, LED drivers, switching regulators and linear regulators for a range of devices, including televisions, smartphones, mobile phones, desktop PCs, notebooks, tablet PCs, other consumer electronics, and industrial applications such as power suppliers, LED lighting, motor control and home appliances. Our Standard Products Group, which includes our Display Solutions and Power Solutions business lines, represented 52.6% and 61.3% of our net sales for the nine months ended September 30, 2017 and September 30, 2016, respectively. Gross profit from our Standard Products Group was \$68.5 million and \$64.8 million for the nine months ended September 30, 2017 and September 30, 2016, respectively.

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Explanation and Reconciliation of Non-US GAAP Measures

Adjusted EBITDA and Adjusted Net Income

We use the terms Adjusted EBITDA and Adjusted Net Income throughout this Report. Adjusted EBITDA, as we define it, is a non-US GAAP measure. We define Adjusted EBITDA for the periods indicated as EBITDA (as defined below), adjusted to exclude (i) restructuring and other charges (gain), net, (ii) early termination charges, (iii) equity-based compensation expense, (iv) foreign currency loss (gain), net, (v) derivative valuation loss (gain), net and (vi) restatement related expenses and other. EBITDA for the periods indicated is defined as net income before interest expense, net, income tax expenses, and depreciation and amortization.

See the footnotes to the table below for further information regarding these items. We present Adjusted EBITDA as a supplemental measure of our performance because:

- we believe that Adjusted EBITDA, by eliminating the impact of a number of items that we do not consider to be indicative of our core ongoing operating performance, provides a more comparable measure of our operating performance from period-to-period and may be a better indicator of future performance;
- we believe that Adjusted EBITDA is commonly requested and used by securities analysts, investors and other interested parties in the evaluation of the Company as an enterprise level performance measure that eliminates the effects of financing, income taxes and the accounting effects of capital spending, as well as other one time or recurring items described above; and
- we believe that Adjusted EBITDA is useful for investors, among other reasons, to assess the Company's period-to-period core operating performance and to understand and assess the manner in which management analyzes operating performance.

We use Adjusted EBITDA in a number of ways, including:

- for planning purposes, including the preparation of our annual operating budget;
- to evaluate the effectiveness of our enterprise level business strategies;
- in communications with our Board of Directors concerning our consolidated financial performance; and
- in certain of our compensation plans as a performance measure for determining incentive compensation payments.

We encourage you to evaluate each adjustment and the reasons we consider them appropriate. In evaluating Adjusted EBITDA, you should be aware that in the future we may incur expenses similar to the adjustments in this presentation. Adjusted EBITDA is not a measure defined in accordance with US GAAP and should not be construed as an alternative to income from continuing operations, cash flows from operating activities or net income, as determined in accordance with US GAAP. A reconciliation of net income to Adjusted EBITDA is as follows:

| | Three Months Ended September 30, 2017 | Nine Months Ended September 30, 2017 | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2016 |
|--|--|---|--|---|
| | (In millions) | | | |
| Net income | \$ 5.6 | \$ 41.3 | \$ 29.9 | \$ 20.2 |
| Interest expense, net | 5.2 | 15.4 | 4.0 | 12.0 |
| Income tax expenses | 0.9 | 2.3 | 0.8 | 1.8 |
| Depreciation and amortization | 7.2 | 20.7 | 6.5 | 18.8 |
| EBITDA | \$ 18.9 | \$ 79.7 | \$ 41.2 | \$ 52.8 |
| Adjustments: | | | | |
| Restructuring and other charges (gain), net(a) | — | (17.0) | — | (5.5) |
| Early termination charges(b) | — | 13.4 | — | 4.2 |
| Equity-based compensation expense(c) | 0.4 | 1.6 | 1.5 | 3.0 |
| Foreign currency loss (gain), net(d) | 3.7 | (26.2) | (33.2) | (34.3) |
| Derivative valuation loss, net(e) | 0.4 | 0.2 | 0.0 | 0.0 |
| Restatement related expenses and other(f) | 1.3 | 6.5 | 0.5 | 6.4 |
| Adjusted EBITDA | \$ 24.7 | \$ 58.1 | \$ 10.0 | \$ 26.6 |

- (a) For the nine months ended September 30, 2017, this adjustment eliminates the \$16.6 million restructuring gain on sale of a building in connection with the closure of our 6-inch fab and the \$0.4 million gain on sale of our sensor business. For the nine months ended September 30, 2016, this adjustment eliminates the \$7.8 million restructuring gain on sale of machinery in connection with the closure of our 6-inch fab, net of \$2.3 million training and transition costs related to our 6-inch fab employees.

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- (b) This adjustment eliminates the charges related to the reduction of workforce through the Headcount Reduction Plan in the first half of 2017 and the Program in the second quarter of 2016. As these termination related charges are recorded as a result of implementing the company-wide headcount reduction and are not expected to represent ongoing operating expenses to us, we believe our operating performance results are more usefully compared if these expenses are excluded.
- (c) This adjustment eliminates the impact of non-cash equity-based compensation expenses. Although we expect to incur non-cash equity-based compensation expenses in the future, these expenses do not generally require cash settlement, and, therefore, are not used by us to assess the profitability of our operations. We believe that analysts and investors will find it helpful to review our operating performance without the effects of these non-cash expenses as supplemental information.
- (d) This adjustment mainly eliminates the impact of non-cash foreign currency translation associated with intercompany debt obligations and foreign currency denominated receivables and payables, as well as the cash impact of foreign currency transaction gains or losses on collection of such receivables and payment of such payables. Although we expect to incur foreign currency gains or losses in the future, we believe that analysts and investors will find it helpful to review our operating performance without the effects of these primarily non-cash gains or losses, which we cannot control. Additionally, we believe the isolation of this adjustment provides investors with enhanced comparability to prior and future periods of our operating performance results.
- (e) This adjustment eliminates the impact of gain or loss recognized in income on derivatives, which represents hedge ineffectiveness or derivatives value changes excluded from the risk being hedged. We enter into derivative transactions to mitigate foreign exchange risks. As our derivative transactions are limited to a certain portion of our expected cash flows denominated in U.S. dollars, and we do not enter into derivative transactions for trading or speculative purposes, we do not believe that these charges or gains are indicative of our core operating performance.
- (f) This adjustment eliminates expenses in connection with the Audit Committee's independent investigation and related restatement and litigation, primarily comprised of legal, audit and consulting fees, and certain other expenses. For the three months ended September 30, 2017, this adjustment eliminates expenses incurred for the secondary offering by the Selling Stockholders. For the nine months ended September 30, 2017, this adjustment eliminates the \$3.0 million civil penalty imposed by the SEC. As these expenses meaningfully impacted our operating results and are not expected to represent an ongoing operating expense to us, we believe our operating performance results are more usefully compared if these expenses are excluded.

There was no tax impact from the adjustments to net income to calculate our Adjusted EBITDA for the three and nine months ended September 30, 2017 and 2016 due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets. We believe that all adjustments to net income used to calculate Adjusted EBITDA were applied consistently to the periods presented.

Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under US GAAP. Some of these limitations are:

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often need to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- Adjusted EBITDA does not consider the potentially dilutive impact of issuing equity-based compensation to our management team and employees;
- Adjusted EBITDA does not reflect the costs of holding certain assets and liabilities in foreign currencies; and
- other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, Adjusted EBITDA should not be considered as a measure of discretionary cash available to us to invest in the growth of our business. We compensate for these limitations by relying primarily on our US GAAP results and using Adjusted EBITDA only supplementally.

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We present Adjusted Net Income (Loss) as a further supplemental measure of our performance. We prepare Adjusted Net Income (Loss) by adjusting net income to eliminate the impact of a number of non-cash expenses and other items that may be either one time or recurring that we do not consider to be indicative of our core ongoing operating performance. We believe that Adjusted Net Income (Loss) is particularly useful because it reflects the impact of our asset base and capital structure on our operating performance. We present Adjusted Net Income (Loss) for a number of reasons, including:

- we use Adjusted Net Income (Loss) in communications with our Board of Directors concerning our consolidated financial performance without the impact of non-cash expenses and the other items as we discussed below since we believe that it is a more consistent measure of our core operating results from period to period; and
- we believe that reporting Adjusted Net Income (Loss) is useful to readers in evaluating our core operating results because it eliminates the effects of non-cash expenses as well as the other items we discuss below, such as foreign currency gains and losses, which are out of our control and can vary significantly from period to period.

Adjusted Net Income (Loss) is not a measure defined in accordance with US GAAP and should not be construed as an alternative to income from continuing operations, cash flows from operating activities or net income, as determined in accordance with US GAAP. We encourage you to evaluate each adjustment and the reasons we consider them appropriate. Other companies in our industry may calculate Adjusted Net Income (Loss) differently than we do, limiting its usefulness as a comparative measure. In addition, in evaluating Adjusted Net Income (Loss), you should be aware that in the future we may incur expenses similar to the adjustments in this presentation. We define Adjusted Net Income (Loss) for the periods indicated as net income, adjusted to exclude (i) restructuring and other charges (gain), net, (ii) early termination charges, (iii) equity-based compensation expense, (iv) foreign currency loss (gain), net, (v) derivative valuation loss (gain), net and (vi) restatement related expenses and other.

The following table summarizes the adjustments to net income that we make in order to calculate Adjusted Net Income (Loss) for the periods indicated:

| | Three Months Ended September 30, 2017 | Nine Months Ended September 30, 2017 | Three Months Ended September 30, 2016 | Nine Months Ended September 30, 2016 |
|--|--|---|--|---|
| | (In millions) | | | |
| Net income | \$ 5.6 | \$ 41.3 | \$ 29.9 | \$ 20.2 |
| Adjustments: | | | | |
| Restructuring and other charges (gain), net(a) | — | (17.0) | — | (5.5) |
| Early termination charges(b) | — | 13.4 | — | 4.2 |
| Equity-based compensation expense(c) | 0.4 | 1.6 | 1.5 | 3.0 |
| Foreign currency loss (gain), net(d) | 3.7 | (26.2) | (33.2) | (34.3) |
| Derivative valuation loss, net(e) | 0.4 | 0.2 | 0.0 | 0.0 |
| Restatement related expenses and other(f) | 1.3 | 6.5 | 0.5 | 6.4 |
| Adjusted Net Income (Loss) | <u>\$ 11.4</u> | <u>\$ 19.7</u> | <u>\$ (1.3)</u> | <u>\$ (6.0)</u> |

- (a) For the nine months ended September 30, 2017, this adjustment eliminates the \$16.6 million restructuring gain on sale of a building in connection with the closure of our 6-inch fab and the \$0.4 million gain on sale of our sensor business. For the nine months ended September 30, 2016, this adjustment eliminates the \$7.8 million restructuring gain on sale of machinery in connection with the closure of our 6-inch fab, net of \$2.3 million training and transition costs related to our 6-inch fab employees.
- (b) This adjustment eliminates the charges related to the reduction of workforce through the Headcount Reduction Plan in the first half of 2017 and the Program in the second quarter of 2016. As these termination related charges are recorded as a result of implementing the company-wide headcount reduction and are not expected to represent ongoing operating expenses to us, we believe our operating performance results are more usefully compared if these expenses are excluded.
- (c) This adjustment eliminates the impact of non-cash equity-based compensation expenses. Although we expect to incur non-cash equity-based compensation expenses in the future, these expenses do not generally require cash settlement, and, therefore, are not used by us to assess the profitability of our operations. We believe that analysts and investors will find it helpful to review our operating performance without the effects of these non-cash expenses as supplemental information.

- (d) This adjustment mainly eliminates the impact of non-cash foreign currency translation associated with intercompany debt obligations and foreign currency denominated receivables and payables, as well as the cash impact of foreign currency transaction gains or losses on collection of such receivables and payment of such payables. Although we expect to incur foreign currency gains or losses in the future, we believe that analysts and investors will find it helpful to review our operating performance without the effects of these primarily non-cash gains or losses, which we cannot control. Additionally, we believe the isolation of this adjustment provides investors with enhanced comparability to prior and future periods of our operating performance results.

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- (e) This adjustment eliminates the impact of gain or loss recognized in income on derivatives, which represents hedge ineffectiveness or derivatives value changes excluded from the risk being hedged. We enter into derivative transactions to mitigate foreign exchange risks. As our derivative transactions are limited to a certain portion of our expected cash flows denominated in U.S. dollars, and we do not enter into derivative transactions for trading or speculative purposes, we do not believe that these charges or gains are indicative of our core operating performance.
- (f) This adjustment eliminates expenses in connection with the Audit Committee's independent investigation and related restatement and litigation, primarily comprised of legal, audit and consulting fees, and certain other expense. For the three months ended September 30, 2017, this adjustment eliminates expenses incurred for the secondary offering by the Selling Stockholders. For the nine months ended September 30, 2017, this adjustment eliminates the \$3.0 million civil penalty imposed by the SEC. As these expenses meaningfully impacted our operating results and are not expected to represent an ongoing operating expense to us, we believe our operating performance results are more usefully compared if these expenses are excluded.

There was no tax impact from the adjustments to net income to calculate our Adjusted Net Income (Loss) for the three and nine months ended September 30, 2017 and 2016 due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets. We believe that all adjustments to net income used to calculate Adjusted Net Income (Loss) were applied consistently to the periods presented.

Adjusted Net Income (Loss) has limitations as an analytical tool, and you should not consider it in isolation, or as a substitute for analysis of our results as reported under US GAAP. Some of these limitations are:

- Adjusted Net Income (Loss) does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted Net Income (Loss) does not consider the potentially dilutive impact of issuing equity-based compensation to our management team and employees;
- Adjusted Net Income (Loss) does not reflect the costs of holding certain assets and liabilities in foreign currencies; and
- other companies in our industry may calculate Adjusted Net Income (Loss) differently than we do, limiting its usefulness as a comparative measure.

Because of these limitations, Adjusted Net Income (Loss) should not be considered as a measure of profitability of our business. We compensate for these limitations by relying primarily on our US GAAP results and using Adjusted Net Income (Loss) only supplementally.

Factors Affecting Our Results of Operations

Net Sales. We derive virtually all of our sales (net of sales returns and allowances) from two segments: Foundry Services Group and Standard Products Group. Our product inventory is primarily located in Korea and is available for drop shipment globally. Outside of Korea, we maintain limited product inventory, and our sales representatives generally relay orders to our factories in Korea for fulfillment. We have strategically located our sales and technical support offices near concentrations of major customers. Our sales offices are located in Korea, the United States, Japan and Greater China. Our network of authorized agents and distributors consists of agents in the United States and Europe and distributors and agents in the Asia Pacific region. Our net sales from All other consist principally of the disposal of scrap materials.

We recognize revenue when risk and reward of ownership pass to the customer either upon shipment, upon product delivery at the customer's location or upon customer acceptance, depending on the terms of the arrangement. For the nine months ended September 30, 2017 and 2016, we sold products to 312 and 321 customers, respectively, and our net sales to our ten largest customers represented 59% and 65% of our net sales, respectively. We have a combined production capacity of approximately 113,000 semiconductor wafers per month. We believe our large-scale, cost-effective fabrication facilities enable us to rapidly adjust our production levels to meet shifts in demand by our end customers.

The new revenue standard could have a material impact on our consolidated financial statements following adoption on January 1, 2018. See "Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements—Note 1—Business, Basis of Presentation and Significant Accounting Policies—Recent Accounting Pronouncements" in this Report for further discussion.

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

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Average Selling Prices. Average selling prices for our products tend to be highest at the time of introduction of new products and tend to decrease over time as such products mature in the market and are replaced by next generation products. We strive to offset the impact of declining selling prices for existing products through our product development activities and by introducing new products that command selling prices above the average selling price of our existing products. In addition, we seek to manage our inventories and manufacturing capacity so as to preclude losses from product and productive capacity obsolescence.

Material Costs. Our cost of material consists of costs of raw materials, such as silicon wafers, chemicals, gases and tape and packaging supplies. We use processes that require specialized raw materials, such as silicon wafers, that are generally available from a limited number of suppliers. If demand increases or supplies decrease, the costs of our raw materials could significantly increase.

Labor Costs. A significant portion of our employees are located in Korea. Under Korean labor laws, most employees and certain 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 September 30, 2017, approximately 98% of our employees were eligible for severance benefits.

Depreciation Expense. We periodically evaluate the carrying values of long-lived assets, including property, plant and equipment and intangible assets, as well as the related depreciation periods. We depreciated our property, plant and equipment using the straight-line method over the estimated useful lives of our assets. Depreciation rates vary from 30-40 years on buildings to 5 to 12 years for certain equipment and assets. Our evaluation of carrying values is based on various analyses including cash flow and profitability projections. If our projections indicate that future undiscounted cash flows are not sufficient to recover the carrying values of the related long-lived assets, the carrying value of the assets is impaired and will be reduced, with the reduction charged to expense so that the carrying value is equal to fair value.

Selling Expenses. We sell our products worldwide through a direct sales force as well as a network of sales agents and representatives to OEMs, including major branded customers and contract manufacturers, and indirectly through distributors. Selling expenses consist primarily of the personnel costs for the members of our direct sales force, a network of sales representatives and other costs of distribution. Personnel costs include base salary, benefits and incentive compensation.

General and Administrative Expenses. General and administrative expenses consist of the costs of various corporate operations, including finance, legal, human resources and other administrative functions. These expenses primarily consist of payroll-related expenses, consulting and other professional fees and office facility-related expenses.

Research and Development. The rapid technological change and product obsolescence that characterize our industry require us to make continuous investments in research and development. Product development time frames vary but, in general, we incur research and development costs one to two years before generating sales from the associated new products. These expenses include personnel costs for members of our engineering workforce, cost of photomasks, silicon wafers and other non-recurring engineering charges related to product design. Additionally, we develop base line process technology through experimentation and through the design and use of characterization wafers that help achieve commercially feasible yields for new products. The majority of research and development expenses are for process development that serves as a common technology platform for all of our product lines.

Interest Expense. Our interest expense was incurred primarily under the 2021 Notes and the Exchangeable Notes.

Impact of Foreign Currency Exchange Rates on Reported Results of Operations. Historically, a portion of our revenues and greater than the majority of our operating expenses and costs of sales have been denominated in non-U.S. currencies, principally the Korean won, and we expect that this will remain true in the future. Because we report our results of operations in U.S. dollars converted from our non-U.S. revenues and expenses based on monthly average exchange rates, changes in the exchange rate between the Korean won and the U.S. dollar could materially impact our reported results of operations and distort period to period comparisons. In particular, because of the difference in the amount of our consolidated revenues and expenses that are in U.S. dollars relative to Korean won, depreciation in the U.S. dollar relative to the Korean won could result in a material increase in reported costs relative to revenues, and therefore could cause our profit margins and operating income (loss) to appear to decline materially, particularly relative to prior periods. The converse is true if the U.S. dollar were to appreciate relative to the Korean won. Moreover, our foreign currency gain or loss would be affected by changes in the exchange rate between the Korean won and the U.S. dollar as a substantial portion of non-cash translation gain or loss is associated with the intercompany long-term loans to our Korean subsidiary, which is denominated in U.S. dollars. As of September 30, 2017, the outstanding intercompany loans balances including accrued interests between our Korean subsidiary and our Dutch subsidiary were \$670 million. This amount included a newly executed intercompany loan of \$75 million during the first quarter of 2017, which was used to transfer a portion of the net proceeds from the offering of the Exchangeable Notes from our Luxembourg subsidiary to our Dutch subsidiary, and then to our Korean subsidiary. As a result of such foreign currency fluctuations, it could be more difficult to detect underlying trends in our business and results of operations. In addition, to the extent that fluctuations in currency exchange rates cause our results of operations to differ from our expectations or the expectations of our investors, the trading price of our stock could be adversely affected.

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From time to time, we may engage in exchange rate hedging activities in an effort to mitigate the impact of exchange rate fluctuations. Our Korean subsidiary enters into foreign currency forward and zero cost collar contracts in order to mitigate a portion of the impact of U.S. dollar-Korean won exchange rate fluctuations on our operating results. Obligations under these foreign currency forward and zero cost collar contracts must be cash collateralized if our exposure exceeds certain specified thresholds. These forward and zero cost collar contracts may be terminated by the counterparty in a number of circumstances, including if our total cash and cash equivalents is less than \$30.0 million at the end of a fiscal quarter unless a waiver is obtained from the counterparty. We cannot assure that any hedging technique we implement will be effective. If our hedging activities are not effective, changes in currency exchange rates may have a more significant impact on our results of operations.

Foreign Currency Gain or Loss. Foreign currency translation gains or losses on transactions by us or our subsidiaries in a currency other than our or our subsidiaries' functional currency are included in our statements of operations as a component of other income (expense). A substantial portion of this net foreign currency gain or loss relates to non-cash translation gain or loss related to the principal balance of intercompany balances at our Korean subsidiary that are denominated in U.S. dollars. This gain or loss results from fluctuations in the exchange rate between the Korean won and U.S. dollar.

Income Taxes. We record our income taxes in each of the tax jurisdictions in which we operate. This process involves using an asset and liability approach whereby deferred tax assets and liabilities are recorded for differences in the financial reporting bases and tax bases of our assets and liabilities. We exercise significant management judgment in determining our provision for income taxes, deferred tax assets and liabilities. We assess whether it is more likely than not that the deferred tax assets existing at the period-end will be realized in future periods. In such assessment, we consider all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent results of operations. In the event we were to determine that we would be able to realize the deferred income tax assets in the future in excess of their net recorded amount, we would adjust the valuation allowance, which would reduce the provision for income taxes.

We are subject to income- or non-income-based tax examinations by tax authorities of the U.S., Korea and multiple other foreign jurisdictions, where applicable, for all open tax years. Significant estimates and judgments are required in determining our worldwide provision for income- or non-income based taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result. See "Item 1, Interim Consolidated Financial Statements— Notes to Consolidated Financial Statements— Note 14. Income Taxes" included elsewhere in this Report.

Capital Expenditures. We invest in manufacturing equipment, software design tools and other tangible and intangible assets mainly for fab maintenance, capacity expansion and technology improvement. Capacity expansions and technology improvements typically occur in anticipation of increases in demand. We typically pay for capital expenditures in partial installments with portions due on order, delivery and final acceptance. Our capital expenditures include our payments for the purchase of property, plant and equipment as well as payments for the registration of intellectual property rights.

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

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Results of Operations – Comparison of Three Months Ended September 30, 2017 and 2016

The following table sets forth consolidated results of operations for the three months ended September 30, 2017 and 2016:

| | Three Months Ended September 30, 2017 | | Three Months Ended September 30, 2016 | | Change Amount |
|--|--|-------------------|--|-------------------|------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales | |
| | (In millions) | | | | |
| Net sales | \$ 176.7 | 100.0% | \$ 192.3 | 100.0% | \$ (15.6) |
| Cost of sales | 126.4 | 71.5 | 153.2 | 79.6 | (26.8) |
| Gross profit | 50.3 | 28.5 | 39.1 | 20.4 | 11.2 |
| Selling, general and administrative expenses | 17.3 | 9.8 | 20.1 | 10.4 | (2.8) |
| Research and development expenses | 17.6 | 9.9 | 18.4 | 9.6 | (0.9) |
| Operating income | 15.5 | 8.8 | 0.6 | 0.3 | 14.9 |
| Interest expenses | (5.5) | (3.1) | (4.1) | (2.1) | (1.4) |
| Foreign currency gain (loss), net | (3.7) | (2.1) | 33.2 | 17.3 | (36.8) |
| Others, net | 0.2 | 0.1 | 0.9 | 0.5 | (0.7) |
| | (8.9) | (5.1) | 30.0 | 15.6 | (39.0) |
| Income before income taxes | 6.5 | 3.7 | 30.6 | 15.9 | (24.1) |
| Income tax expenses | 0.9 | 0.5 | 0.8 | 0.4 | 0.2 |
| Net income | \$ 5.6 | 3.2 | \$ 29.9 | 15.5 | \$ (24.3) |

Results by segment

| | Three Months Ended September 30, 2017 | | Three Months Ended September 30, 2016 | | Change Amount |
|-------------------------------|--|-------------------|--|-------------------|------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales | |
| | (In millions) | | | | |
| Net Sales | | | | | |
| Foundry Services Group | \$ 80.4 | 45.5% | \$ 73.9 | 38.4% | \$ 6.5 |
| Standard Products Group | | | | | |
| Display Solutions | 57.2 | 32.4 | 84.7 | 44.0 | (27.5) |
| Power Solutions | 39.0 | 22.1 | 33.6 | 17.5 | 5.4 |
| Total Standard Products Group | 96.2 | 54.5 | 118.3 | 61.5 | (22.1) |
| All other | 0.1 | 0.0 | 0.1 | 0.1 | (0.1) |
| Total net sales | \$ 176.7 | 100.0% | \$ 192.3 | 100.0% | \$ (15.6) |

| | Three Months Ended September 30, 2017 | | Three Months Ended September 30, 2016 | | Change Amount |
|-------------------------|--|-------------------|--|-------------------|------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales | |
| | (In millions) | | | | |
| Gross Profit | | | | | |
| Foundry Services Group | \$ 24.4 | 30.3% | \$ 17.3 | 23.5% | \$ 7.0 |
| Standard Products Group | 25.9 | 26.9 | 21.7 | 18.3 | 4.2 |
| All other | 0.1 | 100.0 | 0.1 | 100.0 | (0.1) |
| Total gross profit | \$ 50.3 | 28.5 | \$ 39.1 | 20.4 | \$ 11.2 |

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Net Sales

Net sales were \$176.7 million for the three months ended September 30, 2017, a \$15.6 million, or 8.1%, decrease compared to \$192.3 million for the three months ended September 30, 2016. This decrease was primarily attributable to a net decrease in revenue from our Standard Products Group, which was offset in part by an increase in revenue from our Foundry Services Group as described below.

Foundry Services Group. Net sales from our Foundry Services Group segment were \$80.4 million for the three months ended September 30, 2017, a \$6.5 million, or 8.9%, increase compared to \$73.9 million for the three months ended September 30, 2016. The increase was primarily attributable to higher demand for our foundry services from certain customers serving the mid-range smartphone and consumer electronics markets.

Standard Products Group. Net sales from our Standard Products Group segment were \$96.2 million for the three months ended September 30, 2017, a \$22.1 million, or 18.7%, decrease compared to \$118.3 million for the three months ended September 30, 2016. This decrease was primarily attributable to a decrease in revenue from our mobile OLED display driver ICs stemming from a timing mismatch between the expected drop-off in revenue from our existing OLED products and the introduction of new OLED products, and also a lingering slowdown in the China smartphone market exacerbated by the recent delay of certain product launches in China. Such decrease was partially offset by an increase in revenue from large display products mainly due to higher demand of source drivers for ultra high definition TVs and from MOSFETs and premium power products mainly for TV and industrial applications.

All Other. All other net sales were \$0.1 million for the three months ended September 30, 2017 and 2016.

Gross Profit

Total gross profit was \$50.3 million for the three months ended September 30, 2017 compared to \$39.1 million for the three months ended September 30, 2016, an \$11.2 million, or 28.5%, increase. Gross profit as a percentage of net sales for the three months ended September 30, 2017 increased to 28.5% compared to 20.4% for the three months ended September 30, 2016. The increase in gross profit as a percentage of net sales stemmed from both our Foundry Services Group and Standard Products Group segments as described below.

Foundry Services Group. Gross profit from our Foundry Services Group segment was \$24.4 million for the three months ended September 30, 2017, a \$7.0 million, or 40.6%, increase compared to \$17.3 million for the three months ended September 30, 2016. Gross profit as a percentage of net sales for the three months ended September 30, 2017 increased to 30.3% compared to 23.5% for the three months ended September 30, 2016. This increase in gross profit as a percentage of net sales was mainly attributable to a better product mix and increase in utilization rate. The increase was also attributable to a favorable impact from reduction in headcount during 2017.

Standard Products Group. Gross profit from our Standard Products Group segment was \$25.9 million for the three months ended September 30, 2017, a \$4.2 million, or 19.3%, increase from \$21.7 million for the three months ended September 30, 2016. Gross profit as a percentage of net sales for the three months ended September 30, 2017 increased to 26.9% compared to 18.3% for the three months ended September 30, 2016. This increase in gross profit as a percentage of net sales was mainly attributable to a better product mix and increase in utilization rate. The increase was also attributable to a favorable impact from a reduction in headcount during 2017.

All Other. All other gross profits were \$0.1 million for the three months ended September 30, 2017 and 2016.

[Table of Contents](#)**Net Sales by Geographic Region**

We report net sales by geographic region based on the location to which the products are billed. The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the three months ended September 30, 2017 and 2016:

| | Three Months Ended September 30, 2017 | | Three Months Ended September 30, 2016 | | Change Amount |
|---------------------------------|--|-------------------|--|-------------------|------------------|
| | Amount | % of Net Sales | Amount (In millions) | % of Net Sales | |
| Korea | \$ 74.3 | 42.1% | \$ 58.5 | 30.4% | \$ 15.8 |
| Asia Pacific (other than Korea) | 83.2 | 47.1 | 107.6 | 55.9 | (24.3) |
| United States | 8.4 | 4.8 | 15.4 | 8.0 | (7.0) |
| Europe | 10.5 | 5.9 | 10.5 | 5.5 | (0.0) |
| Others | 0.3 | 0.1 | 0.3 | 0.2 | (0.1) |
| | <u>\$ 176.7</u> | <u>100.0%</u> | <u>\$ 192.3</u> | <u>100.0%</u> | <u>\$ (15.6)</u> |

Net sales in Korea for the three months ended September 30, 2017 increased from \$58.5 million to \$74.3 million compared to the three months ended September 30, 2016, or by \$15.8 million, or 27.0%, primarily due to higher demand of large display applications for TVs and our foundry services from certain customers serving the mid-range smartphone and consumer electronics markets. Higher sales of MOSFETs products also had a favorable impact.

Net sales in Asia Pacific (other than Korea) for the three months ended September 30, 2017 decreased from \$107.6 million to \$83.2 million compared to the three months ended September 30, 2016, or by \$24.3 million, or 22.6%, primarily due to lower level of sales of mobile OLED display driver ICs, which was offset in part by an increase in sales of certain products from higher demand for our foundry services and due to a change in billing location from a global power management IC foundry customer.

Net sales in the United States for the three months ended September 30, 2017 decreased from \$15.4 million to \$8.4 million compared to the three months ended September 30, 2016, or by \$7.0 million, or 45.4%, primarily due to a change in billing location and decrease in sales of certain products from a global power management IC foundry customer.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$17.3 million, or 9.8% of net sales, for the three months ended September 30, 2017, compared to \$20.1 million, or 10.4% of net sales, for the three months ended September 30, 2016. The decrease of \$2.8 million, or 14.0%, was primarily attributable to a decrease in salary expense as a result of our headcount reduction and an adjustment of certain accruals related to performance-based compensation expense estimated based on our latest financial assumptions for 2017.

Research and Development Expenses. Research and development expenses were \$17.6 million, or 9.9% of net sales, for the three months ended September 30, 2017, compared to \$18.4 million, or 9.6% of net sales, for the three months ended September 30, 2016. The decrease of \$0.9 million, or 4.8%, was primarily attributable to a decrease in salary expense as a result of our headcount reduction of non-key R&D personnel.

Operating Income

As a result of the foregoing, operating income increased by \$14.9 million for the three months ended September 30, 2017 compared to the three months ended September 30, 2016. As discussed above, the increase in operating income resulted from an \$11.2 million increase in gross profit, a \$2.8 million decrease in selling, general and administrative expenses and a \$0.9 million decrease in research development expenses.

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Other Income

Interest Expenses. Interest expenses were \$5.5 million and \$4.1 million for the three months ended September 30, 2017 and September 30, 2016, respectively. The increase of \$1.4 million was attributable to the interest expense recorded for the Exchangeable Notes issued in January 2017.

Foreign Currency Gain (Loss), Net. Net foreign currency loss for the three months ended September 30, 2017 was \$3.7 million compared to net foreign currency gain of \$33.2 million for the three months ended September 30, 2016. The net foreign currency loss for the three months ended September 30, 2017 was due to the depreciation in value of the Korean won relative to the U.S. dollar during the period. The net foreign currency gain for the three months ended September 30, 2016 was due to the appreciation in value of the Korean won relative to the U.S. dollar during the period.

A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss associated with the intercompany long-term loans to our Korean subsidiary, which is denominated in U.S. dollars, and is affected by changes in the exchange rate between the Korean won and the U.S. dollar. As of September 30, 2017 and September 30, 2016, the outstanding intercompany loan balances including accrued interests between our Korean subsidiary and our Dutch subsidiary were \$670 million and \$591 million, respectively. The increase was primarily attributable to a newly executed intercompany loan of \$75 million during the first quarter of 2017, which was used to transfer a portion of the net proceeds from the offering of the Exchangeable Notes from our Luxembourg subsidiary to our Dutch subsidiary, and then to our Korean subsidiary. Foreign currency translation gain or loss from intercompany balances was included in determining our consolidated net income since the intercompany balances were not considered long-term investments in nature because management intended to settle these intercompany balances at their respective maturity dates.

Others, Net. Others were comprised of rental income, interest income, and gains and losses from valuation of derivatives which were designated as hedging instruments. Others for the three months ended September 30, 2017 and September 30, 2016 was \$0.2 million and \$0.9 million, respectively.

Income Tax Expenses

Income tax expenses for the three months ended September 30, 2017 were \$0.9 million and for the three months ended September 30, 2016 were \$0.8 million. These were primarily related to a reduction in unrecognized tax benefits in the Korean subsidiary and accrued interests on intercompany loans.

Net Income

As a result of the foregoing, net income decreased by \$24.3 million for the three months ended September 30, 2017 compared to the three months ended September 30, 2016. As discussed above, the decrease in net income primarily resulted from a \$36.8 million decrease in net foreign currency gain, which was partially offset by a \$14.9 million increase in operating income.

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Results of Operations – Comparison of Nine Months Ended September 30, 2017 and 2016

The following table sets forth consolidated results of operations for the nine months ended September 30, 2017 and 2016:

| | Nine Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | | Change Amount |
|--|---|-------------------|---|-------------------|------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales | |
| | (In millions) | | | | |
| Net sales | \$ 505.1 | 100.0% | \$ 507.5 | 100.0% | \$ (2.4) |
| Cost of sales | 366.6 | 72.6 | 397.4 | 78.3 | (30.8) |
| Gross profit | 138.5 | 27.4 | 110.1 | 21.7 | 28.4 |
| Selling, general and administrative expenses | 58.1 | 11.5 | 60.4 | 11.9 | (2.3) |
| Research and development expenses | 52.4 | 10.4 | 54.4 | 10.7 | (2.0) |
| Restructuring and other charges (gain), net | (17.0) | (3.4) | (6.5) | (1.3) | (10.5) |
| Early termination charges | 13.4 | 2.6 | 4.2 | 0.8 | 9.1 |
| Operating income (loss) | 31.6 | 6.3 | (2.5) | (0.5) | 34.1 |
| Interest expenses | (16.1) | (3.2) | (12.2) | (2.4) | (3.9) |
| Foreign currency gain, net | 26.2 | 5.2 | 34.3 | 6.8 | (8.0) |
| Others, net | 1.9 | 0.4 | 2.4 | 0.5 | (0.5) |
| | 12.0 | 2.4 | 24.5 | 4.8 | (12.5) |
| Income before income taxes | 43.6 | 8.6 | 22.0 | 4.3 | 21.6 |
| Income tax expenses | 2.3 | 0.5 | 1.8 | 0.4 | 0.5 |
| Net income | \$ 41.3 | 8.2 | \$ 20.2 | 4.0 | \$ 21.1 |

Results by segment

| | Nine Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | | Change Amount |
|-------------------------------|---|-------------------|---|-------------------|------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales | |
| | (In millions) | | | | |
| Net Sales | | | | | |
| Foundry Services Group | \$ 239.5 | 47.4% | \$ 196.2 | 38.7% | \$ 43.3 |
| Standard Products Group | | | | | |
| Display Solutions | 155.9 | 30.9 | 217.2 | 42.8 | (61.3) |
| Power Solutions | 109.6 | 21.7 | 93.8 | 18.5 | 15.8 |
| Total Standard Products Group | 265.5 | 52.6 | 310.9 | 61.3 | (45.5) |
| All other | 0.2 | 0.0 | 0.4 | 0.1 | (0.3) |
| Total net sales | \$ 505.1 | 100.0% | \$ 507.5 | 100.0% | \$ (2.4) |

| | Nine Months Ended September 30, 2017 | | Nine Months Ended September 30, 2016 | | Change Amount |
|-------------------------|---|-------------------|---|-------------------|------------------|
| | Amount | % of Net Sales | Amount | % of Net Sales | |
| | (In millions) | | | | |
| Gross Profit | | | | | |
| Foundry Services Group | \$ 69.9 | 29.2% | \$ 45.8 | 23.4% | \$ 24.1 |
| Standard Products Group | 68.5 | 25.8 | 64.8 | 20.9 | 3.6 |
| All other | 0.2 | 100.0 | (0.5) | (119.6) | 0.7 |
| Total gross profit | \$ 138.5 | 27.4 | \$ 110.1 | 21.7 | \$ 28.4 |

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Net Sales

Net sales were \$505.1 million for the nine months ended September 30, 2017, a \$2.4 million, or 0.5%, decrease compared to \$507.5 million for the nine months ended September 30, 2016. This decrease was primarily attributable to a net decrease in revenue from our Standard Products Group, which was offset in part by an increase in revenue from our Foundry Services Group as described below.

Foundry Services Group. Net sales from our Foundry Services Group segment were \$239.5 million for the nine months ended September 30, 2017, a \$43.3 million, or 22.1%, increase compared to net sales of \$196.2 million for the nine months ended September 30, 2016. The increase was primarily attributable to higher sales of certain products from global power management IC foundry customers and higher demand for our foundry services from certain customers serving the mid-range smartphone and consumer electronics markets. These increases were partially offset by a net decrease in demand of our foundry services from a customer serving the high-end smartphone market.

Standard Products Group. Net sales from our Standard Products Group segment were \$265.5 million for the nine months ended September 30, 2017, a \$45.5 million, or 14.6%, decrease compared to \$310.9 million for the nine months ended September 30, 2016. This decrease was primarily attributable to a decrease in revenue from our mobile OLED display driver ICs stemming from a timing mismatch between the expected drop-off in revenue from our existing OLED products and the introduction of new OLED products, and also a lingering slowdown in the China smartphone market exacerbated by the recent delay of certain product launches in China. Such decrease was partially offset by an increase in revenue from large display products mainly due to higher demand of source drivers for ultra high definition TVs and from MOSFETs and premium power products for TV and industrial applications.

All Other. All other net sales were \$0.2 million for the nine months ended September 30, 2017 and \$0.4 million for the nine months ended September 30, 2016, respectively.

Gross Profit

Total gross profit was \$138.5 million for the nine months ended September 30, 2017 compared to \$110.1 million for the nine months ended September 30, 2016, a \$28.4 million, or 25.8%, increase. Gross profit as a percentage of net sales for the nine months ended September 30, 2017 increased to 27.4% compared to 21.7% for the nine months ended September 30, 2016. The increase in gross profit as a percentage of net sales was primarily due to an increase in gross profit from our Foundry Services Group segment as described below.

Foundry Services Group. Gross profit from our Foundry Services Group segment was \$69.9 million for the nine months ended September 30, 2017, a \$24.1 million, or 52.5%, increase compared to \$45.8 million for the nine months ended September 30, 2016. Gross profit as a percentage of net sales for the nine months ended September 30, 2017 increased to 29.2% compared to 23.4% for the nine months ended September 30, 2016. The increase in gross profit as a percentage of net sales was mainly attributable to a better product mix and increase in utilization rate. Our product mix improved partly due to ending the production and sale of legacy low margin products that were manufactured in our 6-inch fab, which was closed during the first quarter of 2016. The increase was also attributable to a favorable impact from reduction in headcount.

Standard Products Group. Gross profit from our Standard Products Group segment was \$68.5 million for the nine months ended September 30, 2017, a \$3.6 million, or 5.6%, increase from \$64.8 million for the nine months ended September 30, 2016. Gross profit as a percentage of net sales for the nine months ended September 30, 2017 increased to 25.8% compared to 20.9% for the nine months ended September 30, 2016. The increase in gross profit as a percentage of net sales was mainly attributable to the favorable impact of a higher utilization rate and reduction in headcount during 2017.

All Other. All other gross profit for the nine months ended September 30, 2017 was \$0.2 million. All other gross profit for the nine months ended September 30, 2016 was negative \$0.5 million mainly attributable to training and transition costs related to our closed 6-inch fab employees, which was partially offset by revenue from the disposal of waste materials.

[Table of Contents](#)**Net Sales by Geographic Region**

We report net sales by geographic region based on the location to which the products are billed. The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the nine months ended September 30, 2017 and 2016:

| | <u>Nine Months Ended September 30, 2017</u> | | <u>Nine Months Ended September 30, 2016</u> | | <u>Change Amount</u> |
|---------------------------------|---|---------------------------|---|---------------------------|--------------------------|
| | <u>Amount</u> | <u>% of Net Sales</u> | <u>Amount</u> | <u>% of Net Sales</u> | |
| | | | (In millions) | | |
| Korea | \$207.4 | 41.1% | \$156.0 | 30.7% | \$ 51.4 |
| Asia Pacific (other than Korea) | 239.2 | 47.4 | 289.5 | 57.0 | (50.2) |
| United States | 28.7 | 5.7 | 28.5 | 5.6 | 0.2 |
| Europe | 29.1 | 5.8 | 32.8 | 6.5 | (3.7) |
| Others | 0.7 | 0.1 | 0.8 | 0.2 | (0.1) |
| | <u>\$505.1</u> | <u>100.0%</u> | <u>\$507.5</u> | <u>100.0%</u> | <u>\$ (2.4)</u> |

Net sales in Korea for the nine months ended September 30, 2017 increased from \$156.0 million to \$207.4 million compared to the nine months ended September 30, 2016, or by \$51.4 million, or 33.0%, primarily due to higher demand of large display applications for TVs and our foundry services from certain customers serving the mid-range smartphone and consumer electronics markets. Higher sales of MOSFETs products also had a favorable impact.

Net sales in Asia Pacific for the nine months ended September 30, 2017 decreased from \$289.5 million to \$239.2 million compared to the nine months ended September 30, 2016, or by \$50.2 million, or 17.4%, primarily due to lower level of sales of mobile OLED display driver ICs, which was partially offset by an increase in sales of certain products from higher demand for our foundry services and due to a change in billing location from a global power management IC foundry customer.

Net sales in Europe for the nine months ended September 30, 2017 decreased from \$32.8 million to \$29.1 million compared to the nine months ended September 30, 2016, or by \$3.7 million, or 11.3%, primarily due to lower demand of our foundry services from a customer serving the high-end smartphone market.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general, and administrative expenses were \$58.1 million, or 11.5% of net sales, for the nine months ended September 30, 2017, compared to \$60.4 million, or 11.9% of net sales, for the nine months ended September 30, 2016. The decrease of \$2.3 million, or 3.8%, was primarily attributable to a decrease in salary expense as a result of our headcount reduction and a decrease in professional fees mainly comprised of legal and consulting fees, which was partially offset by the civil penalty paid in connection with the final settlement with the SEC.

Research and Development Expenses. Research and development expenses were \$52.4 million, or 10.4% of net sales, for the nine months ended September 30, 2017, compared to \$54.4 million, or 10.7% of net sales, for the nine months ended September 30, 2016. The decrease of \$2.0 million, or 3.7%, was primarily attributable to a decrease in salary expense as a result of our headcount reduction of non-key R&D personnel.

Restructuring and Other Charges (Gain), Net. Restructuring and other charges (gain), net of \$17.0 million recorded for the nine months ended September 30, 2017 resulted from a \$16.6 million restructuring gain on the sale of the building related to the closure of our 6-inch fab and a \$0.4 million gain on sale of our sensor business. Restructuring and other charges (gain), net of \$6.5 million recorded for the nine months ended September 30, 2016 resulted from the sale of machinery related to the closure of our 6-inch fab, which was offset by \$1.3 million of training and transition costs related to the employees at our closed 6-inch fab.

Early Termination Charges. Termination related charges related to the reduction of workforce through the Headcount Reduction Plan for the nine months ended September 30, 2017 and the Program for the nine months ended September 30, 2016 were \$13.4 million and \$4.2 million, respectively.

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Operating Income (Loss)

As a result of the foregoing, an operating loss of \$2.5 million for the nine months ended September 30, 2016 turned to operating income of \$31.6 million for the nine months ended September 30, 2017. This \$34.1 million increase in operating income resulted from a \$28.4 million increase in gross profit, a \$10.5 million increase in restructuring and other gain, net, which was partially offset by a \$9.1 million increase in early termination charges.

Other Income

Interest Expenses. Interest expense was \$16.1 million for the nine months ended September 30, 2017 and \$12.2 million for the nine months ended September 30, 2016. The increase of \$ 3.9 million was attributable to the interest expense recorded for the Exchangeable Notes issued in January 2017.

Foreign Currency Gain, Net. Net foreign currency gain for the nine months ended September 30, 2017 was \$26.2 million compared to net foreign currency gain of \$34.3 million for the nine months ended September 30, 2016. The net foreign currency gain for the nine months ended September 30, 2017 and 2016 was due to the appreciation in value of the Korean won relative to the U.S. dollar during the periods.

A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss associated with the intercompany long-term loans to our Korean subsidiary, which is denominated in U.S. dollars, and is affected by changes in the exchange rate between the Korean won and the U.S. dollar. As of September 30, 2017 and September 30, 2016, the outstanding intercompany loan balances including accrued interests between our Korean subsidiary and our Dutch subsidiary were \$670 million and \$591 million, respectively. The increase was primarily attributable to a newly executed intercompany loan of \$75 million during the first quarter of 2017, which was used to transfer a portion of the net proceeds from the offering of the Exchangeable Notes from our Luxembourg subsidiary to our Dutch subsidiary, and then to our Korean subsidiary. Foreign currency translation gain or loss from intercompany balances was included in determining our consolidated net income since the intercompany balances were not considered long-term investments in nature because management intended to settle these intercompany balances at their respective maturity dates.

Others, Net. Others were comprised of gains and losses on the valuation of derivatives which were designated as hedging instruments, rental income and interest income. Others for the nine months ended September 30, 2017 and September 30, 2016 was \$1.9 million and \$2.4 million, respectively.

Income Tax Expenses

Income tax expenses for the nine months ended September 30, 2017 and 2016 were \$2.3 million and \$1.8 million, respectively. The increase in income tax expenses was primarily attributable to changes in unrecognized tax benefits as a result of a lapse of the applicable statute of limitations in the Korean subsidiary and an increase in accrued interests on intercompany loans.

Net Income

As a result of the foregoing, net income increased by \$21.1 million for the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. As discussed above, the increase in net income primarily resulted from a \$34.1 million increase in operating income, which was partially offset by a \$3.9 million increase in interest expenses and an \$8.0 million decrease in net foreign currency gain.

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Liquidity and Capital Resources

Our principal capital requirements are to fund sales and marketing, invest in research and development and capital equipment, to make debt service payments and to fund working capital needs. We calculate working capital as current assets less current liabilities.

Our principal sources of liquidity are our cash, cash equivalents, our cash flows from operations and our financing activities. Our ability to manage cash and cash equivalents may be limited, as our primary cash flows are dictated by the terms of our sales and supply agreements, contractual obligations, debt instruments and legal and regulatory requirements. From time to time, we may sell accounts receivable to third parties under factoring agreements or engage in accounts receivable discounting to facilitate the collection of cash. For a description of our factoring arrangements and accounts receivable discounting, please see “Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements—Note 2. Sales of Accounts Receivable and Receivable Discount Program” included elsewhere in this Report. In addition, from time to time, we may make payments to our vendors on extended terms with their consent. As of September 30, 2017, we do not have any accounts payable on extended terms or payment deferral with our vendors.

On January 17, 2017, MagnaChip Semiconductor S.A., our Luxembourg subsidiary, closed the Exchangeable Notes Offering of the Exchangeable Notes with \$86.25 million aggregate principal amount, reflecting the full exercise of the initial purchasers’ option to purchase additional Exchangeable Notes. We used a portion of the net proceeds from the Exchangeable Notes Offering to repurchase approximately \$11.4 million of our common stock as part of our stock repurchase program.

We currently believe that we will have sufficient cash reserves from cash on hand and expected cash from operations to fund our operations as well as capital expenditures for the next twelve months and the foreseeable future.

Cash Flows from Operating Activities

Cash outflow used in operating activities totaled \$22.5 million for the nine months ended September 30, 2017, compared to \$13.9 million for the nine months ended September 30, 2016. The net operating cash outflow for the nine months ended September 30, 2017 reflects our net income of \$41.3 million and adjustments of \$8.0 million which mainly consisted of depreciation and amortization, provision for severance benefits, net foreign currency gain and restructuring gain and other, and a net decrease in operating assets and liabilities of \$55.7 million. The decrease in changes in operating assets and liabilities was mainly attributable to a significant decrease in accounts receivable discounting during the nine months of 2017 and the payments of statutory severance to the employees that resigned from the Company.

Our working capital balance as of September 30, 2017 was \$176.4 million compared to \$89.3 million as of December 31, 2016. The \$87.1 million increase was primarily attributable to a \$45.1 million increase in cash and cash equivalents, a \$24.3 million increase in accounts receivable, net and a \$15.0 million decrease in accrued expenses.

Cash Flows from Investing Activities

Cash outflow used in investing activities totaled \$6.4 million for the nine months ended September 30, 2017, compared to \$7.8 million of cash outflow used in investing activities for the nine months ended September 30, 2016. The \$1.4 million increase was attributable to a \$10.4 million net increase in proceeds from disposal of plant, property and equipment and a \$1.1 million net decrease in guarantee deposits, which was partly offset by a \$10.1 million net increase in hedge collateral.

Cash Flows from Financing Activities

Cash inflow generated by financing activities totaled \$72.3 million for the nine months ended September 30, 2017, compared to \$1.5 million of cash inflow from financing activities for the nine months ended September 30, 2016. The \$70.8 million increase was attributable to \$80.3 million of net proceeds received from the issuance of the Exchangeable Notes and \$1.9 million increase in proceeds received from the exercised stock options, which was partly offset by the payment of \$11.4 million for the repurchase of 1,795,444 shares of our common stock in January 2017 pursuant to our stock repurchase plan.

Capital Expenditures

We routinely make capital expenditures for fab maintenance, enhancement of our existing facilities and reinforcement of our global research and development capability. For the nine months ended September 30, 2017, capital expenditures (including payments for intellectual property registration) were \$20.2 million, an \$8.1 million, or 67.3%, increase from \$12.1 million for the nine months ended September 30, 2016. The increase was mainly due to equipment purchased to support demand of certain process technology.

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Contractual Obligations

The following summarizes our contractual obligations as of September 30, 2017:

| | Payments Due by Period | | | | | | |
|-----------------------------------|------------------------|-------------------------|--------|--------|--------|---------|------------|
| | Total | Remainder of 2017 | 2018 | 2019 | 2020 | 2021 | Thereafter |
| Exchangeable Notes ⁽¹⁾ | \$101.3 | \$ — | \$ 4.3 | \$ 4.3 | \$ 4.3 | \$ 88.4 | \$ — |
| 2021 Notes ⁽²⁾ | 284.6 | — | 14.9 | 14.9 | 14.9 | 239.9 | — |
| Operating lease ⁽³⁾ | 27.0 | 1.7 | 4.8 | 2.0 | 1.6 | 1.2 | 15.7 |
| Others ⁽⁴⁾ | 11.9 | 3.3 | 5.4 | 1.2 | 1.1 | 1.1 | — |

- (1) Interest payments as well as \$86.25 million aggregate principal amount of the Exchangeable Notes outstanding as of September 30, 2017, which bear interest at a rate of 5.0% per annum and are scheduled to mature in 2021 if not earlier converted or redeemed.
- (2) Interest payments as well as \$225.0 million aggregate principal amount of the 2021 Notes outstanding as of September 30, 2017, which bear interest at a rate of 6.625% per annum and are scheduled to mature in 2021 if not earlier redeemed.
- (3) Assumes constant currency exchange rate for Korean won to U.S. dollars of 1,146.7:1, the exchange rate as of September 30, 2017.
- (4) Includes license agreements and other contractual obligations.

The indentures relating to the Exchangeable Notes and the 2021 Notes contain covenants as detailed in “Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements— Note 9. Long-Term Borrowings” in this Report. Those covenants are subject to a number of exceptions and qualifications. Certain of those restrictive covenants will terminate if the Exchangeable Notes or the 2021 Notes are rated investment grade at any time.

We lease land, office space and equipment under various operating lease agreements that expire through 2034.

We follow accounting guidance on uncertain tax positions. Our unrecognized tax benefits totaled \$2.4 million as of September 30, 2017. These unrecognized tax benefits have been excluded from the above table because we cannot estimate the period of cash settlement with the respective taxing authorities.

Although we are obligated to pay severance benefits to eligible employees with one or more years of service upon the termination of their employment based on their length of service and rate pay, we have no obligation to fund the accrued severance benefits. Our accrued severance benefits totaled \$132.3 million as of September 30, 2017. Our obligations in connection with severance benefits have been excluded from the above table because we are unable to reasonably estimate the rate of termination and related cash payments for future period.

Critical Accounting Policies and Estimates

Preparing financial statements in conformity with US GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the date of the financial statements, the reported amounts of revenues and expenses during the reporting periods and the related disclosures in our consolidated financial statements and accompanying notes.

We believe that our significant accounting policies, which are described further in Note 1 to our consolidated financial statements in our 2016 Form 10-K, are critical due to the fact that they involve a high degree of judgment and estimates about the effects of matters that are inherently uncertain. We base these estimates and judgments on historical experience, knowledge of current conditions and other assumptions and information that we believe to be reasonable. Estimates and assumptions about future events and their effects cannot be determined with certainty. Accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the business environment in which we operate changes.

A description of our critical accounting policies that involve significant management judgement appears in our 2016 Form 10-K, under “Management’s Discussion and Analysis of Financial Conditions and Reports of Operations—Critical Accounting Policies and Estimates.” There have been no material changes to our critical accounting policies and estimates as compared to our critical accounting policies and estimates included in our 2016 Form 10-K.

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Recent Accounting Pronouncements

For a full description of new accounting pronouncements and recently adopted accounting pronouncements, please see “Item 1. Interim Consolidated Financial Statements—Notes to Consolidated Financial Statements—Note 1. Business, Basis of Presentation and Significant Accounting Policies” in this Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign Currency Exposures

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 September 30, 2017 for our Korean subsidiary, a 10% devaluation of the Korean won against the U.S. dollar would have resulted in a decrease of \$2.1 million in our U.S. dollar financial instruments and cash balances.

See “Note 7. Derivative Financial Instruments” to our consolidated financial statements under “Item 1. Interim Consolidated Financial Statements” and “Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Factors Affecting Our Results of Operations—Impact of Foreign Currency Exchange Rates on Reported Results of Operations” for additional information regarding our foreign exchange hedging activities.

Interest Rate Exposures

As of September 30, 2017, \$86.25 million aggregate principal amount of our Exchangeable Notes were outstanding. Interest on the Exchangeable Notes accrues at a fixed rate of 5.0% per annum and is paid semi-annually every March 1 and September 1 of each year until the Exchangeable Notes mature on March 1, 2021. As of September 30, 2017, \$225.0 million aggregate principal amount of our 2021 Notes were also outstanding. Interest on the 2021 Notes accrues at a fixed rate of 6.625% per annum and is paid semi-annually every January 15 and July 15 of each year until the 2021 Notes mature on July 15, 2021. Since the interest rates are fixed, we have no market risk related to the Exchangeable Notes and the 2021 Notes.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our periodic reports filed or submitted under the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms, and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

In connection with the preparation of this Report, we carried out an evaluation under the supervision of and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, as of September 30, 2017, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2017.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings, see “Part I: Item 3. Legal Proceedings” of our 2016 Form 10-K.

See also “Part I: Item 1A. Risk Factors” of our 2016 Form 10-K and Note 18 to our consolidated financial statements in this Report for additional information.

Item 1A. Risk Factors

The Company is subject to risks and uncertainties, any of which could have a significant or material adverse effect on our business, financial condition, liquidity or consolidated financial statements. You should carefully consider the risk factors disclosed in Part I, Item 1A of our 2016 Form 10-K and other reports we have filed with the SEC. The risks described herein and therein are not the only ones we face. This information should be considered carefully together with the other information contained in this Report and the other reports and materials the Company files with the SEC.

There are no material changes to the Company’s risk factors disclosed in “Part I: Item 1A. Risk Factors” of our 2016 Form 10-K.

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Item 6. Exhibits.

| <u>Exhibit Number</u> | <u>Description</u> |
|---------------------------|---|
| 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. |
| 101.INS# | XBRL Instance Document. |
| 101.SCH# | XBRL Taxonomy Extension Schema Document. |
| 101.CAL# | XBRL Taxonomy Extension Calculation Linkbase Document. |
| 101.DEF# | XBRL Taxonomy Extension Definition Linkbase Document. |
| 101.LAB# | XBRL Taxonomy Extension Label Linkbase Document. |
| 101.PRE# | XBRL Taxonomy Extension Presentation Linkbase Document. |

Footnotes:

- # Filed herewith
† Furnished herewith

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 CORPORATION
(Registrant)

Dated: November 8, 2017

By: /s/ Young-Joon Kim
Young-Joon Kim
Chief Executive Officer
(Principal Executive Officer)

Dated: November 8, 2017

By: /s/ Jonathan W. Kim
Jonathan W. Kim
Chief Financial Officer, Executive Vice President and
Chief Accounting Officer
(Principal Financial and Accounting Officer)

**CERTIFICATION OF PRINCIPAL EXECUTIVE OFFICER
PURSUANT TO
SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Young-Joon Kim, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MagnaChip Semiconductor Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 8, 2017

/s/ Young-Joon Kim

Young-Joon Kim
Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION OF PRINCIPAL FINANCIAL OFFICER
PURSUANT TO
SECTION 302 OF THE
SARBANES-OXLEY ACT OF 2002**

I, Jonathan W. Kim, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MagnaChip Semiconductor Corporation;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: November 8, 2017

/s/ Jonathan W. Kim

Jonathan W. Kim
Chief Financial Officer
(Principal Financial and Accounting Officer)

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of MagnaChip Semiconductor Corporation (the “**Company**”) hereby certifies, to such officer’s knowledge, that:

(i) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the “**Report**”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

Dated: November 8, 2017

/s/ Young-Joon Kim

Young-Joon Kim
Chief Executive Officer
(Principal Executive Officer)

The foregoing certification is being furnished solely pursuant to 18 U.S.C § 1350 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference in any registration statement of the Company filed under the Securities Act of 1933, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

**CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of MagnaChip Semiconductor Corporation (the “**Company**”) hereby certifies, to such officer’s knowledge, that:

(i) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2017 as filed with the Securities and Exchange Commission on the date hereof (the “**Report**”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

(ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company as of the dates and for the periods expressed in the Report.

Dated: November 8, 2017

/s/ Jonathan W. Kim

Jonathan W. Kim

Chief Financial Officer

(Principal Financial and Accounting Officer)

The foregoing certification is being furnished solely pursuant to 18 U.S.C § 1350 and shall not be deemed filed by the Company for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or incorporated by reference in any registration statement of the Company filed under the Securities Act of 1933, as amended.

A signed original of this written statement required by Section 906 has been provided to the Company and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

