

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark one)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended October 2, 2005

or

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from \_\_\_\_\_ to \_\_\_\_\_.

Commission file number 333-126019-09

**MAGNACHIP SEMICONDUCTOR LLC**  
(Exact name of Registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

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

**c/o MagnaChip Semiconductor S.A.**  
**10, rue de Vianden, L-2680**  
**Luxembourg, Grand Duchy of Luxembourg**  
(Address of principal executive offices)

**Not Applicable**  
(Zip Code)

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

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

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

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 November 14, 2005, the registrant had 53,037,319.672 of the registrant's common units outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

## MagnaChip Semiconductor LLC and Subsidiaries

## Condensed Consolidated Statements of Operations

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

	Three months ended October 2, 2005	Nine months ended October 2, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2004
	(Successor Company)		(Predecessor Company)	
Net sales				
Related party	\$ —	\$ —	\$ 41,258	\$ 163,760
Others	243,089	692,502	236,150	677,828
	<u>243,089</u>	<u>692,502</u>	<u>277,408</u>	<u>841,588</u>
Cost of sales	181,177	544,234	220,589	654,569
	<u>181,177</u>	<u>544,234</u>	<u>220,589</u>	<u>654,569</u>
Gross profit	61,912	148,268	56,819	187,019
	<u>61,912</u>	<u>148,268</u>	<u>56,819</u>	<u>187,019</u>
Selling, general and administrative expenses	28,166	89,163	18,029	53,982
Research and development expenses	27,043	80,630	27,453	75,657
Restructuring and impairment charges	—	8,720	—	—
	<u>—</u>	<u>8,720</u>	<u>—</u>	<u>—</u>
Operating income (loss)	6,703	(30,245)	11,337	57,380
	<u>6,703</u>	<u>(30,245)</u>	<u>11,337</u>	<u>57,380</u>
Other income (expenses)				
Interest expense, net	(14,944)	(42,836)	(4,876)	(17,749)
Foreign currency gain (loss), net	(5,473)	(4,667)	(261)	5,364
Others	—	—	312	1,070
	<u>(20,417)</u>	<u>(47,503)</u>	<u>(4,825)</u>	<u>(11,315)</u>
Income (loss) before income taxes	(13,714)	(77,748)	6,512	46,065
	<u>(13,714)</u>	<u>(77,748)</u>	<u>6,512</u>	<u>46,065</u>
Income tax expenses (benefits)	(472)	256	764	2,828
	<u>(472)</u>	<u>256</u>	<u>764</u>	<u>2,828</u>
Net income (loss)	\$ (13,242)	\$ (78,004)	\$ 5,748	\$ 43,237
	<u>(13,242)</u>	<u>(78,004)</u>	<u>5,748</u>	<u>43,237</u>
Non cash dividends to preferred unitholders	2,506	7,379		
	<u>2,506</u>	<u>7,379</u>		
Net loss attributable to common units	\$ (15,748)	\$ (85,383)		
	<u>(15,748)</u>	<u>(85,383)</u>		
Net loss per common units				
- Basic and diluted	\$ (0.30)	\$ (1.62)		
	<u>(0.30)</u>	<u>(1.62)</u>		
Weighted average number of units				
- Basic and diluted	53,037,320	52,848,430		

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

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

	October 2, 2005	December 31, 2004
<b>Assets</b>		
Current assets		
Cash and cash equivalents	\$ 71,027	\$ 58,396
Restricted cash	5,163	12,962
Accounts receivable, net	116,508	86,592
Inventories, net	82,963	86,169
Other receivables	7,582	72,918
Other current assets	7,530	6,915
<b>Total current assets</b>	<b>290,773</b>	<b>323,952</b>
Property, plant and equipment, net	498,308	581,636
Intangibles, net	210,163	211,987
Other non-current assets	53,826	36,955
<b>Total assets</b>	<b>\$ 1,053,070</b>	<b>\$ 1,154,530</b>
<b>Liabilities and Unitholders' Equity</b>		
Current liabilities		
Accounts payable	\$ 79,906	\$ 66,163
Other accounts payable	23,083	86,462
Accrued expenses	38,384	31,413
Short-term borrowings	11,118	749
Other current liabilities	10,254	9,892
<b>Total current liabilities</b>	<b>162,745</b>	<b>194,679</b>
Long-term borrowings	750,000	750,000
Accrued severance benefits, net	52,166	50,714
Other non-current liabilities	8,912	6,731
<b>Total liabilities</b>	<b>973,823</b>	<b>1,002,124</b>
Commitments and contingencies		
Series A redeemable convertible preferred units; 60,000 units authorized; 50,091 units issued and 0 units outstanding at October 2, 2005 and December 31, 2004	—	—
Series B redeemable convertible preferred units; 550,000 units authorized; 450,693 units issued and 93,997 units outstanding at October 2, 2005 and December 31, 2004	103,913	96,534
<b>Total redeemable convertible preferred units</b>	<b>103,913</b>	<b>96,534</b>
Unitholders' equity		
Common units; 65,000,000 units authorized; 53,037,320 units and 52,533,003 units issued and outstanding at October 2, 2005 and December 31, 2004, respectively	53,037	52,533
Additional paid-in capital	2,110	2,100
Accumulated deficit	(104,649)	(19,266)
Accumulated other comprehensive income	24,836	20,505
<b>Total unitholders' equity (deficit)</b>	<b>(24,666)</b>	<b>55,872</b>
<b>Total liabilities, redeemable convertible preferred units and unitholders' equity</b>	<b>\$ 1,053,070</b>	<b>\$ 1,154,530</b>

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

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

	Nine months ended October 2, 2005	Nine months ended September 30, 2004
	(Successor Company)	(Predecessor Company)
<b>Cash flows from operating activities</b>		
Net income (loss)	\$ (78,004)	\$ 43,237
Adjustments to reconcile net income (loss) to net cash provided by operating activities		
Depreciation and amortization	154,748	266,862
Provision for severance benefits	12,189	15,353
Amortization of debt issuance costs	2,561	—
Loss on foreign currency translation, net	5,451	—
(Gain) on disposal of property, plant and equipment, net	(860)	(488)
Impairment charges on property, plant and equipment	7,996	—
Stock compensation	—	3,324
Others, net	(1,662)	(673)
Changes in operating assets and liabilities		
Accounts receivable	(31,257)	(7,067)
Inventories	2,637	(18,070)
Other receivables	65,323	—
Accounts payable	12,233	(5,719)
Other accounts payable	(76,377)	18,329
Accrued expenses	4,564	584
Other current assets	2,684	(1,177)
Other current liabilities	(438)	1,450
Payment of severance benefits	(10,664)	(6,602)
Others, net	(13,918)	2,828
Net cash provided by operating activities	57,206	312,171
<b>Cash flows from investing activities</b>		
Purchase of plant, property and equipment	(39,839)	(84,595)
Purchases of intangibles, net	(1,614)	(2,128)
Acquisition of business	(16,451)	—
Decrease in restricted cash	7,876	—
Others, net	3,120	1,392
Net cash used in investing activities	(46,908)	(85,331)
<b>Cash flows from financing activities</b>		
Repayment of short-term borrowings	(12,400)	(46,978)
Repayment of long-term borrowings	—	(179,862)
Proceeds from short-term borrowings	10,578	—
Others, net	(80)	—
Net cash used in financing activities	(1,902)	(226,840)
Effect of exchange rates on cash and cash equivalents	(385)	—
Net decrease in cash and cash equivalents	8,011	—
<b>Cash and cash equivalents</b>		
Beginning of the period	58,396	—
Net increase in cash and cash equivalents from changes of consolidated subsidiaries	4,620	—
End of the period	\$ 71,027	\$ —

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

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

**1. Basis of Presentation**

The accompanying unaudited interim consolidated financial statements of MagnaChip Semiconductor LLC and its subsidiaries (successor company) (the "Company") have been prepared in accordance with Accounting Principle Board ("APB") Opinion No. 28, *Interim Financial Reporting* regarding interim financial information and, accordingly, do not include all of the information and note disclosures required by generally accepted accounting principles in the United States of America for complete financial statements. These financial statements should be read in conjunction with the consolidated financial statements and notes thereto for the three-month period ended December 31, 2004, and for the nine-month period ended September 30, 2004, which are included in our S-4 Registration Statement that was filed on June 21, 2005, and the amendments thereto, with the Securities and Exchange Commission. In the opinion of the Company's management, the unaudited interim consolidated financial statements include all normal recurring adjustments necessary to present fairly the information required to be set forth therein. The results of operations for the three-month and nine-month periods ended October 2, 2005 are not necessarily indicative of the results to be expected for a full year or for any other periods.

For the periods as of and prior to September 30, 2004, the accompanying unaudited interim consolidated financial statements are presented on a carve-out basis reflecting the assets, liabilities, revenues, expenses and changes in owner's equity and cash flows that were directly attributable to the non-memory business (the "Business") of Hynix Semiconductor, Inc., which was purchased on October 6, 2004 (the "Acquisition"). The Company has used October 1, 2004, as the effective date of the Acquisition since the financial results from October 1, 2004 onwards accrue to its benefit.

**2. Inventories**

Inventories as of October 2, 2005 and December 31, 2004 consist of the following:

	<u>October 2, 2005</u>	<u>December 31, 2004</u>
Finished goods	\$ 19,821	\$ 28,431
Semi-finished goods and work-in-progress	64,569	55,563
Raw materials	4,904	7,599
Materials in-transit	4,562	850
Less: valuation allowance	(10,893)	(6,274)
Inventories, net	<u>\$ 82,963</u>	<u>\$ 86,169</u>

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

**3. Product Warranties**

Accrued warranty liabilities as of October 2, 2005 and December 31, 2004 are as follows:

	October 2, 2005	December 31, 2004
Balance at January 1, 2005 and October 1, 2004	\$ 1,448	\$ 2,677
Accrued (reduced) warranty reserve	1,500	(977)
Costs incurred	(1,705)	(477)
Translation adjustments	(6)	225
<b>Balance at October 2, 2005 and December 31, 2004</b>	<b>\$ 1,237</b>	<b>\$ 1,448</b>

**4. Short-term and Long-term Borrowings**

Details of short-term borrowings as of October 2, 2005 and December 31, 2004 are as follows:

	October 2, 2005		December 31, 2004	
	Annual interest rate (%)	Amount of principal	Annual interest rate (%)	Amount of principal
Banker's Usance	2.81 ~ 4.95	\$ 11,118	1.05 ~ 1.55	\$ 749

Details of long-term borrowings as of October 2, 2005 and December 31, 2004 are presented as below:

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

**Interest Rate Swap:** Effective June 27, 2005, the Company entered into an interest rate swap agreement (the "Swap") that converted the variable interest rate based on the 3-month London Inter-bank Offering Rate ("LIBOR") plus 3.25% to fixed interest rate on the Company's Floating Rate Second Priority Senior Secured Notes (the "Notes"). This Swap will be in effect until 15 June, 2008.

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

For the three and nine-month periods ended October 2, 2005, the Company recorded changes in the fair value of the Swap amounting to \$2,962,033 and \$3,045,399, respectively, under other comprehensive income in the accompanying consolidated financial statements. In addition, during the same periods, the Company recognized additional interest expense of \$435,333 and \$475,000, respectively, which represent the differences between fixed and variable rate.

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

**5. Accrued Severance Benefits**

Changes in accrued severance benefits for the three and nine-month periods ended October 2, 2005 (successor company) and for the three and nine-month periods ended September 30, 2004 (predecessor company) are as follows:

	Three months ended October 2, 2005	Nine months ended October 2, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2004
	(Successor Company)		(Predecessor Company)	
Beginning balance	\$ 53,870	\$ 52,925	\$ 50,793	\$ 40,015
Provisions	4,063	12,189	3,840	15,353
Transferred from acquired company	—	196	—	—
Severance payments	(3,201)	(10,664)	(4,763)	(6,837)
Effect of foreign currency translation and other	(694)	(608)	133	1,472
	<u>54,038</u>	<u>54,038</u>	<u>50,003</u>	<u>50,003</u>
Less: Cumulative contributions to the National Pension Fund	(950)	(950)	(1,304)	(1,304)
Group Severance insurance plan	(922)	(922)	(1,202)	(1,202)
	<u>\$ 52,166</u>	<u>\$ 52,166</u>	<u>\$ 47,497</u>	<u>\$ 47,497</u>

The severance benefits are funded approximately 3.46% and 5.01% as of October 2, 2005 and September 30, 2004, respectively, through our national pension fund and group severance insurance deposit plan which will be used exclusively for payment of severance benefits to eligible employees. These amounts have been deducted from the accrued severance benefit balance.

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

	Retirement benefit
2005 - 2008	\$ —
2009	65
2010 - 2014	1,235

The above amounts were determined based on the employees' current rate of salary and the number of service years that will be accumulated when they would meet their normal retirement date. These amounts do not include amounts that might be paid to employees who may terminate employment with the Company before their normal retirement age.



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

**6. Series B Redeemable Convertible Preferred Units**

Changes in series B redeemable convertible preferred units for the three and nine-month periods ended October 2, 2005 were as follows:

	Three months ended October 2, 2005		Nine months ended October 2, 2005	
	Units	Amounts	Units	Amounts
Beginning of period	93,997	\$ 101,407	93,997	\$ 96,534
Accrual of non cash preferred dividends	—	2,506	—	7,379
End of period	93,997	\$ 103,913	93,997	\$ 103,913

**7. Earnings per Unit**

The following table illustrates the computation of basic loss per common unit for the three and nine-month periods ended October 2, 2005.

	Three months ended October 2, 2005	Nine months ended October 2, 2005
Net loss	\$ (13,242)	\$ (78,004)
Non cash dividends to preferred unitholders	2,506	7,379
Net loss attributable to common units	\$ (15,748)	\$ (85,383)
Weighted-average common units outstanding	53,037,320	52,848,430
Basic loss per unit	\$ (0.30)	\$ (1.62)

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

	Three and Nine months ended October 2, 2005
Redeemable convertible preferred units	93,997
Options	3,536,080
Warrants	5,079,254

In connection with the Acquisition, the Company issued a warrant to Hynix which enables Hynix to purchase 5,079,254 common units of the Company at an exercise price of \$1.00 per unit. This warrant expires on October 6, 2006. Refer to Note 8. Unit-Based Compensation for details of option grants.

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

**8. Unit-Based Compensation**

In addition to 1,146,178 options to purchase the Company's common units outstanding as of January 1, 2005, the Company granted on January 5, 2005, 1,922,500 options to purchase common units to management and employees with exercise prices ranging from \$1 to \$3 per unit. Under the Company's Equity Incentive Plan, 25% of the units vested with a right to exercise by the option holder on September 30, 2005 and 6.25% of the units will vest with a right to exercise on the last day of each calendar quarter thereafter pursuant to the resolution approved by board of directors.

Subsequent to the grants on January 5, 2005, the Company additionally granted 900,062 options to purchase common units to its management and employees with exercise prices ranging from \$1 to \$3 per unit. Most of these options have a vesting term of 25% of the units on the first anniversary of the grant date and 6.25% of the units on the last day of each calendar quarter thereafter pursuant to the resolution of the Company's board of directors.

During the nine months ended October 2, 2005, 432,660 of previously issued options to purchase common units were forfeited.

The Company accounts for unit-based awards to employees using the intrinsic value method prescribed by Accounting Principles Board ("APB") Opinion No. 25, *Accounting for Stock Issued to Employees*; accordingly, no compensation cost was recorded for the nine months ended October 2, 2005. The Company utilizes the Black-Scholes option valuation model to value options for pro forma presentation of income as if the fair value based accounting method in SFAS No. 123, *Accounting for Stock-Based Compensation*, had been used to account for unit-based compensation and the Company's adjusted net income (loss) would have increased and is illustrated in the pro forma table below:

	Three months ended October 2, 2005	Nine months ended October 2, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2004
	(Successor Company)		(Predecessor Company)	
As reported net income (loss)	\$ (13,242)	\$ (78,004)	\$ 5,748	\$ 43,237
Add: Amortization of non-cash deferred unit compensation expense determined under the intrinsic value method as reported in net income, net of tax	—	—	(550)	3,324
Deduct: Total unit-based employee compensation expense determined under the fair value method for all awards, net of tax	(109)	(327)	(3,849)	(5,614)
Pro forma net income (loss)	\$ (13,351)	\$ (78,331)	\$ 1,349	\$ 40,947
Pro forma loss per unit	\$ (0.30)	\$ (1.62)		

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

The weighted average fair value of options granted during the three and nine months ended October 2, 2005 (Successor Company) was \$0.09 and \$0.22, respectively.

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option-pricing model based on the following set of assumptions (average-weight):

Expected life	2.2 Years
Expected volatility	60.3%
Risk-free interest rate	3.0%
Expected dividends	—

### 9. Restructuring and Impairment Charges

During the nine months ended October 2, 2005, the Company recorded restructuring and asset impairment charges totaling \$8,720 thousand, as the Company determined that recent strategic decisions to outsource some of the manufacturing processes would impact future cash flows of certain capital equipment used specifically for packaging and testing of one of the Company's product lines. Based on such decisions, the Company recognized an impairment charge of \$7,996 thousand for long-lived assets under Statements of Financial Accounting Standards No. 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* as well as a one time restructuring charge of \$724 thousand for completion of an early retirement program.

### 10. Comprehensive Income

Comprehensive income is as follows:

	Three months ended October 2, 2005	Nine months ended October 2, 2005	Three months ended September 30, 2004	Nine months ended September 30, 2004
	(Successor Company)		(Predecessor Company)	
Net income (loss)	\$ (13,242)	\$ (78,004)	\$ 5,748	\$ 43,237
Fair valuation of derivatives	2,962	3,045	—	—
Foreign currency translation effect and others	(1,246)	1,286	210	4,842
Comprehensive income (loss)	<u>\$ (11,526)</u>	<u>\$ (73,673)</u>	<u>\$ 5,958</u>	<u>\$ 48,079</u>

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

**11. Condensed Consolidating Financial Statements**

The senior secured credit facility and Second Priority Senior Secured Notes are each fully and unconditionally guaranteed by MagnaChip Semiconductor LLC and all of its subsidiaries, except for Shanghai Ximei Corporation (China) and IC Media Japan Kabushiki Kaisha (Japan). The Senior Subordinated Notes are fully and unconditionally guaranteed by MagnaChip Semiconductor LLC and all of its subsidiaries, except for MagnaChip Semiconductor, Ltd. (Korea), Shanghai Ximei Corporation (China) and IC Media Japan Kabushiki Kaisha (Japan). Below are the condensed consolidating balance sheets as of October 2, 2005 and December 31, 2004, condensed consolidating statements of operations for the three and nine months ended October 2, 2005 (Successor Company) and condensed consolidating statement of cash flows for the nine months ended October 2, 2005 of those entities that guarantee the Senior Subordinated Notes, those that do not, MagnaChip Semiconductor LLC, and the co-issuers.

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

**Condensed Consolidating Balance Sheet**  
**October 2, 2005**

	MagnaChip Semiconductor LLC (Parent)	MagnaChip Semiconductor Finance Company & MagnaChip Semiconductor S.A. (Co-Issuers)	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Assets</b>						
<b>Current assets</b>						
Cash and cash equivalents	\$ 281	\$ 667	\$ 48,751	\$ 21,328	\$ —	\$ 71,027
Restricted cash	—	—	5,163	—	—	5,163
Accounts receivable, net	—	—	128,931	53,238	(65,661)	116,508
Inventories, net	—	—	76,461	7,969	(1,467)	82,963
Other receivables	35,014	718	6,489	35,097	(69,736)	7,582
Short-term inter company loans	—	5,625	—	14,000	(19,625)	—
Other current assets	—	27,009	8,741	10,172	(38,392)	7,530
<b>Total current assets</b>	<b>35,295</b>	<b>34,019</b>	<b>274,536</b>	<b>141,804</b>	<b>(194,881)</b>	<b>290,773</b>
Property, plant and equipment, net	—	—	497,117	1,191	—	498,308
Intangibles, net	—	—	183,152	27,011	—	210,163
Investments in subsidiaries	44,952	(24,914)	—	155,681	(175,719)	—
Long-term inter company loans	—	776,755	—	621,000	(1,397,755)	—
Other non-current assets	—	23,339	44,742	12,804	(27,059)	53,826
<b>Total assets</b>	<b>\$ 80,247</b>	<b>\$ 809,199</b>	<b>\$ 999,547</b>	<b>\$959,491</b>	<b>\$(1,795,414)</b>	<b>\$1,053,070</b>
<b>Liabilities and Unitholders' equity</b>						
<b>Current liabilities</b>						
Accounts payable	\$ —	\$ —	\$ 80,310	\$ 65,257	\$ (65,661)	\$ 79,906
Other accounts payable	1,000	435	55,900	35,484	(69,736)	23,083
Accrued expenses	—	11,531	33,347	28,675	(35,169)	38,384
Short-term borrowings	—	—	11,118	19,625	(19,625)	11,118
Other current liabilities	—	124	3,483	9,870	(3,223)	10,254
<b>Total current liabilities</b>	<b>1,000</b>	<b>12,090</b>	<b>184,158</b>	<b>158,911</b>	<b>(193,414)</b>	<b>162,745</b>
Long-term borrowings	—	750,000	621,000	776,755	(1,397,755)	750,000
Accrued severance benefits, net	—	—	51,911	255	—	52,166
Other non-current liabilities	—	—	6,849	29,122	(27,059)	8,912
<b>Total liabilities</b>	<b>1,000</b>	<b>762,090</b>	<b>863,918</b>	<b>965,043</b>	<b>(1,618,228)</b>	<b>973,823</b>

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

**Condensed Consolidating Balance Sheet**

October 2, 2005

	MagnaChip Semiconductor LLC (Parent)	MagnaChip Semiconductor Finance Company & MagnaChip Semiconductor S.A. (Co-Issuers)	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Commitments and contingencies</b>						
Series A redeemable convertible preferred units	—	—	—	—	—	—
Series B redeemable convertible preferred unites	103,913	—	—	—	—	103,913
<b>Total redeemable convertible preferred units</b>	<b>103,913</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>103,913</b>
<b>Unitholders' equity</b>						
Common units	53,037	102,986	38,845	61,063	(202,894)	53,037
Additional paid-in capital	2,110	1,027	155,212	63,371	(219,610)	2,110
Accumulated deficit	(104,649)	(81,911)	(80,573)	(153,376)	315,860	(104,649)
Accumulated other comprehensive income	24,836	25,007	22,145	23,390	(70,542)	24,836
<b>Total unitholders' equity (deficit)</b>	<b>(24,666)</b>	<b>47,109</b>	<b>135,629</b>	<b>(5,552)</b>	<b>(177,186)</b>	<b>(24,666)</b>
<b>Total liabilities, redeemable convertible preferred units and unitholders' equity</b>	<b>\$ 80,247</b>	<b>\$ 809,199</b>	<b>\$999,547</b>	<b>\$ 959,491</b>	<b>\$(1,795,414)</b>	<b>\$1,053,070</b>

**MagnaChip Semiconductor LLC and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – (Continued)**  
(tabular dollars in thousands, except unit data)

**Condensed Consolidating Balance Sheet**  
**December 31, 2004**

	MagnaChip Semiconductor LLC (Parent)	MagnaChip Semiconductor Finance Company & MagnaChip Semiconductor S.A. (Co-Issuers)	Non-Guarantors	Guarantors	Eliminations	Consolidated
<b>Assets</b>						
<b>Current assets</b>						
Cash and cash equivalents	\$ 2,386	\$ 3,201	\$ 29,671	\$ 23,138	\$ —	\$ 58,396
Restricted cash	—	—	12,962	—	—	12,962
Accounts receivable, net	—	—	99,125	42,724	(55,257)	86,592
Inventories, net	—	—	77,338	10,380	(1,549)	86,169
Other receivables	34,773	1,544	70,857	2,061	(36,317)	72,918
Short-term inter company loans	—	10,625	—	—	(10,625)	—
Other current assets	—	5,909	5,196	1,719	(5,909)	6,915
<b>Total current assets</b>	<b>37,159</b>	<b>21,279</b>	<b>295,149</b>	<b>80,022</b>	<b>(109,657)</b>	<b>323,952</b>
Property, plant and equipment, net	—	—	581,514	122	—	581,636
Intangibles, net	—	—	211,981	6	—	211,987
Investments in subsidiaries	116,409	29,231	—	205,358	(350,998)	—
Long-term inter company loans	—	794,805	—	619,991	(1,414,796)	—
Other non-current assets	—	21,869	15,026	60	—	36,955
<b>Total assets</b>	<b>\$ 153,568</b>	<b>\$ 867,184</b>	<b>\$ 1,103,670</b>	<b>\$ 905,559</b>	<b>\$ (1,875,451)</b>	<b>\$ 1,154,530</b>
<b>Liabilities and Unitholders' equity</b>						
<b>Current liabilities</b>						
Accounts payable	\$ —	\$ —	\$ 64,688	\$ 56,732	\$ (55,257)	\$ 66,163
Other accounts payable	1,162	252	118,572	2,793	(36,317)	86,462
Accrued expenses	—	1,129	29,950	6,243	(5,909)	31,413
Short-term borrowings	—	—	749	8,650	(8,650)	749
Other current liabilities	—	—	8,878	1,014	—	9,892
<b>Total current liabilities</b>	<b>1,162</b>	<b>1,381</b>	<b>222,837</b>	<b>75,432</b>	<b>(106,133)</b>	<b>194,679</b>
Long-term borrowings	—	750,000	619,991	796,780	(1,416,771)	750,000
Accrued severance benefits, net	—	—	50,702	12	—	50,714
Other non-current liabilities	—	—	4,783	1,948	—	6,731
<b>Total liabilities</b>	<b>1,162</b>	<b>751,381</b>	<b>898,313</b>	<b>874,172</b>	<b>(1,522,904)</b>	<b>1,002,124</b>

**MagnaChip Semiconductor LLC and Subsidiaries**  
**Notes to Condensed Consolidated Financial Statements – (Continued)**  
(tabular dollars in thousands, except unit data)

**Condensed Consolidating Balance Sheet**  
**December 31, 2004**

	MagnaChip Semiconductor LLC (Parent)	MagnaChip Semiconductor Finance Company & MagnaChip Semiconductor S.A. (Co-Issuers)	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Commitments and contingencies</b>						
Series A redeemable convertible preferred units	—	—	—	—	—	—
Series B redeemable convertible preferred unites	96,534	—	—	—	—	96,534
<b>Total redeemable convertible preferred units</b>	<b>96,534</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>96,534</b>
<b>Unitholders' equity</b>						
Common units	52,533	102,986	38,845	261	(142,092)	52,533
Additional paid-in capital	2,100	1,027	155,212	29,370	(185,609)	2,100
Accumulated deficit	(19,266)	(8,715)	(9,420)	(18,784)	36,919	(19,266)
Accumulated other comprehensive income	20,505	20,505	20,720	20,540	(61,765)	20,505
<b>Total unitholders' equity</b>	<b>55,872</b>	<b>115,803</b>	<b>205,357</b>	<b>31,387</b>	<b>(352,547)</b>	<b>55,872</b>
<b>Total liabilities, redeemable convertible preferred units and unitholders' equity</b>	<b>\$ 153,568</b>	<b>\$ 867,184</b>	<b>\$ 1,103,670</b>	<b>\$905,559</b>	<b>\$(1,875,451)</b>	<b>\$1,154,530</b>



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

**Condensed Consolidating Statement of Operations**  
**For the nine months ended October 2, 2005**

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

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

**Condensed Consolidating Statement of Operations**  
For the three months ended October 2, 2005

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

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

**Condensed Consolidating Statement of Cash Flows**  
**For the nine months ended October 2, 2005**

	MagnaChip Semiconductor LLC (Parent)	MagnaChip Semiconductor Finance Company & MagnaChip Semiconductor S.A. (Co-Issuers)	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Cash flow from operating activities:</b>						
Net income (loss)	\$ (78,004)	\$ (73,196)	\$ (71,153)	\$ (62,834)	\$ 207,183	\$ (78,004)
Adjustments to reconcile net loss to net cash provided by (used in) operating						
Depreciation and amortization	—	—	149,561	5,187	—	154,748
Provision for severance benefits	—	—	12,117	72	—	12,189
Amortization of debt issuance costs	—	1,955	606	—	—	2,561
(Gain) loss on foreign currency translation, net	—	19,059	4,181	(17,789)	—	5,451
(Gain) loss on disposal of property, plant and equipment, net	—	—	(861)	1	—	(860)
Impairment charges on property, plant and equipment	—	—	7,996	—	—	7,996
Loss (earnings) of related investment	77,657	60,600	—	68,916	(207,173)	—
Others, net	—	—	(1,728)	66	—	(1,662)
Changes in operating assets and liabilities:						
Accounts receivable	—	—	(30,556)	(11,105)	10,404	(31,257)
Inventories	—	—	87	2,029	521	2,637
Other receivables	(241)	826	65,289	(33,970)	33,419	65,323
Accounts payable	—	—	16,567	6,070	(10,404)	12,233
Other accounts payable	(160)	183	(72,206)	29,225	(33,419)	(76,377)
Accrued expenses	—	10,403	3,644	19,777	(29,260)	4,564
Other current assets	—	(21,100)	2,285	(7,761)	29,260	2,684
Other current liabilities	—	123	(5,455)	4,894	—	(438)
Payment of severance benefits	—	—	(10,653)	(11)	—	(10,664)
Others, net	—	—	(31,611)	19,605	(1,912)	(13,918)
Net cash provided by (used in) operating activities	(748)	(1,147)	38,110	22,372	(1,381)	57,206

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

**Condensed Consolidating Statement of Cash Flows**  
**For the nine months ended October 2, 2005**

	MagnaChip Semiconductor LLC (Parent)	MagnaChip Semiconductor Finance Company & MagnaChip Semiconductor S.A. (Co-Issuers)	Non- Guarantors	Guarantors	Eliminations	Consolidated
<b>Cash flows from investing activities:</b>						
Purchases of plant, property and equipment	—	—	(39,729)	(511)	401	(39,839)
Purchase of intangibles, net	—	—	(1,614)	—	—	(1,614)
Acquisition of business	(1,870)	—	—	(14,581)	—	(16,451)
Decrease (increase) of intercompany loans	—	(1,009)	—	(15,009)	16,018	—
Decrease in restricted cash	—	—	7,876	—	—	7,876
Others, net	—	—	2,997	524	(401)	3,120
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net cash used in investing activities	(1,870)	(1,009)	(30,470)	(29,577)	16,018	(46,908)
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Cash flows from financing activities:</b>						
Repayment of short-term borrowings	—	—	—	(12,400)	—	(12,400)
Proceeds from short-term borrowings	—	—	10,578	14,000	(14,000)	10,578
Proceeds from long-term borrowings	—	—	1,009	1,009	(2,018)	—
Others, net	513	(378)	(215)	—	—	(80)
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
Net cash provided by (used in) financing activities	513	(378)	11,372	2,609	(16,018)	(1,902)
Effect of exchange rate on cash and cash equivalents	—	—	68	(1,834)	1,381	(385)
Net increase in cash and cash equivalents	(2,105)	(2,534)	19,080	(6,430)	—	8,011
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
<b>Cash and cash equivalents:</b>						
Beginning of the period	2,386	3,201	29,671	23,138	—	58,396
Net increase in cash and cash equivalents from changes of consolidated subsidiaries	—	—	—	4,620	—	4,620
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>
End of the period	\$ 281	\$ 667	\$ 48,751	\$ 21,328	\$ —	\$ 71,027
	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>—</u>

**PART I. Financial Information – (continued)**

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

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

**Overview**

We are a leading designer, developer and manufacturer of mixed-signal and digital multimedia semiconductors addressing the convergence of consumer electronics and communication devices. We focus our core business on Complementary Metal-Oxide Semiconductor (“CMOS”) image sensors and flat panel display drivers, which are complex, high-performance mixed-signal semiconductors that capture images and enable and enhance the features and capabilities of both small and large flat panel displays. We also provide wafer foundry services utilizing CMOS high voltage, embedded memory, analog and power process technologies for the manufacture of IC’s for customer-owned designs. Our solutions are used in a wide variety of consumer and commercial mass market applications, such as mobile handsets, including camera-equipped mobile handsets, flat panel monitors and televisions, consumer home and mobile displays, portable and desktop computer displays, handheld gaming devices, PDAs and audio-visual equipment such as DVD players.

We derive our net sales from products and services in three principal areas: CMOS imaging solutions, display solutions, and semiconductor manufacturing services.

- *CMOS imaging solutions:* Our CMOS image sensor solutions are used in image-capture applications such as camera-equipped mobile handsets, personal computer cameras, fingerprint sensors and surveillance cameras. Our highly integrated image sensors are designed to be cost-effective and to provide brighter, sharper, more colorful, and thus enhanced, image quality.
- *Display solutions:* Our flat panel display drivers are used in several major types of large and small flat panel displays, including TFT-LCD, Color-STN and OLED displays. Our flat panel display solutions are used in applications such as mobile handsets, flat panel televisions, displays for portable and desktop computers, handheld gaming devices and PDAs. We produce highly integrated flat panel display driver solutions and have pioneered developments in embedded memory and in the design and manufacturing of display drivers, enabling our customers to provide improved picture quality through thinner, smaller and more power efficient displays.

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- *Semiconductor manufacturing services:* We use our process technology and manufacturing facilities to manufacture semiconductor wafers for third parties based on their designs. Our five fabs have a combined capacity of over 115,000 eight-inch equivalent wafers per month and are located in Cheongju and Gumi, Korea. Our fabs provide us with large scale, cost-effective and flexible capacity enabling us to rapidly scale to high volume to meet shifts in demand by our end customers.

Our business was named MagnaChip Semiconductor when it was acquired from Hynix Semiconductor on October 6, 2004, by Citigroup Venture Capital Equity Partners, or CVC, Francisco Partners, CVC Asia Pacific, certain members of management and other investors, following discussions with Hynix that began in late 2001 and the execution of a definitive agreement in June 2004. Previously, we were the System IC division within Hynix which, in 1999, had been formed from a merger between the Hyundai Electronics and LG Semiconductor System IC businesses and can trace its history back to the late 1970s. Although we were previously part of Hynix, our business had a history of operating autonomously within Hynix and had a separate global sales force and management structure.

### **Basis of Presentation**

Prior to October 1, 2004, our consolidated financial statements were prepared on a carve-out basis from the consolidated financial statements and accounting records of Hynix using the actual results of operations and actual basis of assets and liabilities of our business. The consolidated statements of operations include allocations of certain raw materials, other assets and accounts payable which our business has historically shared with Hynix, and allocations of certain manufacturing costs, general and administrative, sales and marketing, and other miscellaneous expenses. These allocations were made on a specifically identifiable basis or using the relative percentages, as compared to Hynix's other businesses, of sales, headcount, raw material consumption or other reasonable methods. We and Hynix considered these allocations to be a reasonable reflection of the utilization of services provided. Our expenses as a separate, stand alone company may be higher or lower than the amounts reflected in the consolidated statements of operations.

We believe the assumptions underlying the consolidated financial statements are reasonable. However, the consolidated financial statements may not necessarily reflect our results of operations, financial position and cash flows in the future or what our results of operations, financial position and cash flows would have been had we been a separate stand-alone company during the historical carve-out periods presented. As part of the Acquisition, we did not acquire certain assets that were included in the carve-out financial statements and we assumed certain additional obligations that are not reflected in the carve-out financial statements. Accordingly, the carve-out financial statements should not be relied upon as being representative of our financial position or operating results had we operated on a stand alone basis, nor may they be representative of our financial position or operating results following the Acquisition.

**Results of Operations - Comparison of Three-Month Periods Ended October 2, 2005 and September 30, 2004**

	Three months ended October 2, 2005		Three months ended September 30, 2004		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
<i>(in millions of US dollars)</i>						
Net sales						
Related party	\$ —	—	\$ 41.3	14.9%	\$ (41.3)	(100.0)%
Others	243.1	100.0%	236.1	85.1%	7.0	3.0%
	243.1	100.0%	277.4	100.0%	(34.3)	(12.4)%
Cost of sales	181.2	74.5%	220.6	79.5%	(39.4)	(17.9)%
Gross profit	61.9	25.5%	56.8	20.5%	5.1	9.0%
Selling, general and administrative expenses	28.2	11.6%	18.0	6.5%	10.2	56.7%
Research and development expenses	27.0	11.1%	27.5	9.9%	(0.5)	(1.8)%
Operating income	6.7	2.8%	11.3	4.1%	(4.6)	(40.7)%
Interest expense, net	(14.9)	(6.1)%	(4.9)	(1.8)%	(10.0)	204.1%
Foreign currency gain (loss), net	(5.5)	(2.3)%	(0.2)	(0.1)%	(5.3)	n/a
Others	—	—	0.3	0.1%	(0.3)	(100.0)%
Income (loss) before income taxes	(13.7)	(5.6)%	6.5	2.3%	(20.2)	(310.8)%
Income tax expenses (benefit)	(0.5)	(0.2)%	0.8	0.3%	(1.3)	(162.5)%
Net income (loss)	\$ (13.2)	(5.4)%	\$ 5.7	2.0%	\$ (18.9)	(331.6)%

*Net Sales.* Net sales for the three-month period ended October 2, 2005 were \$243.1 million, a \$34.3 million or 12.4% decrease from \$277.4 million for the three-month period ended September 30, 2004. The reduction from prior-year revenue was primarily due to a decrease of \$32.5 million or 78.7% in DRAM foundry business with Hynix. This reduction was due to our strategic decision to focus manufacturing capacity and processes on expanding CMOS image sensor capability, which should help improve prospects for increased profitability and growth in the long term. The effect of this decision was a reduction in available capacity to supply Hynix with memory products and lower sales.

Revenues from our core business for the three month period ended October 2, 2005 increased \$4.3 million or 2.0% from \$217.3 million for the three month period ended September 30, 2004. The slight increase was related to a shift in mix and generally favorable revenue trends in our display solution business and an increase in market demand. Revenue decreases in our imaging solution business and semiconductor manufacturing services were attributable to lower average sales prices and the timing of new design wins ramping into volume production. Our application processor revenue decreased as a result of repositioning these products, de-emphasizing optical storage device products to focus on consumer appliance and mobile device application areas. We believe that this is more in line with our global focus and we can leverage our infrastructure to maximize opportunity in larger markets.

Net sales to related parties in the quarter ended October 2, 2005 decreased by \$41.3 million from the third quarter of 2004. Subsequent to the Acquisition date, all sales made to Hynix were classified as customer sales as the two companies are now separate and do not require related party revenue classification. Net sales to others for the quarter ended October 2, 2005 increased by \$7.0 million or 3.0 % from the third quarter in the prior year.

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*Cost of Sales.* Cost of sales was \$181.2 million in the third quarter of 2005, a \$39.4 million or 17.9% decrease from \$220.6 million in the third quarter of 2004. The decrease was primarily due to a lower revenue base and a reduction in depreciation expenses associated with the application of purchase accounting in connection with the Acquisition. Cost of sales as a percentage of net sales decreased by 5.0% to 74.5% in the current-year period from 79.5% in the prior-year period.

*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$28.2 million or 11.6% of net sales for the three months ended October 2, 2005. This represents a \$10.2 million or 56.7% increase from \$18.0 million or 6.5% of net sales in the three months ended September 30, 2004. The increase in selling, general and administrative expenses was primarily attributable to amortization of intangible assets recorded in purchase accounting as a result of the Acquisition. We also recognized increased professional fees related to consulting and infrastructure build-out as well as additional warranty reserves to cover possible exposure of future claims from customers.

*Research and Development Expenses.* Research and development expenses were relatively flat at \$27.0 million in the three-month period ended October 2, 2005, compared to \$27.5 million in the three months ended September 30, 2004. We continue to invest in our research and development centers worldwide and process technology to support next generation products. As a percentage of net sales, research and development expense increased to 11.1% during the third quarter of 2005 from 9.9% in the third quarter of 2004.

*Operating Income.* Operating income for the three-month period ended October 2, 2005 was \$6.7 million, a \$4.6 million or 40.7% decrease from the operating income of \$11.3 million for the three-month period ended September 30, 2004. Operating income as a percentage of net sales was 2.8% and 4.1% in the third quarters of 2005 and 2004, respectively.

*Net Interest Expense.* Net interest expense was \$14.9 million during the three-month period ended October 2, 2005, a \$10.0 million increase from \$4.9 million for the three-month period ended September 30, 2004. The increase in net interest expense was primarily due to the interest expense from the long-term debt of \$750.0 million in the current year quarter versus \$249.1 million in long-term debt on a carve-out basis at September 30, 2004. Refer to Note 4. Short-term and Long-term Borrowings for details.

*Income Tax Expense (Benefit).* Income tax benefit was \$0.5 million in the third quarter of 2005, compared to income tax expense of \$0.8 million in the same quarter of 2004. Income tax benefit for the quarter ended October 2, 2005 was primarily attributable to the increase of a deferred tax asset based on expected future utilization of the Company's cumulative tax net operating loss. This tax benefit is offset by the effect of the Korean withholding tax on the interest income paid to our Korean subsidiary's parent company. Due to the uncertainty of utilization for foreign tax credits, the Korean withholding tax was treated as a current tax expense to the Company.



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**Results of Operations - Comparison of Nine - Month Periods Ended October 2, 2005 and September 30, 2004**

	Nine months ended October 2, 2005		Nine months ended September 30, 2004		Change	
	Amount	% of net sales	Amount	% of net sales	Amount	%
<i>(in millions of US dollars)</i>						
Net sales						
Related party	\$ —	—	\$ 163.8	19.5%	\$(163.8)	(100.0)%
Others	692.5	100.0%	677.8	80.5%	14.7	2.2%
	692.5	100.0%	841.6	100.0%	(149.1)	(17.7)%
Cost of sales	544.2	78.6%	654.6	77.8%	(110.4)	(16.9)%
Gross profit	148.3	21.4%	187.0	22.2%	(38.7)	(20.7)%
Selling, general and administrative expenses	89.2	12.9%	54.0	6.4%	35.2	65.2%
Research and development expenses	80.6	11.6%	75.7	9.0%	4.9	6.5%
Restructuring and impairment charges	8.7	1.3%	—	—	8.7	n/a
Operating income (loss)	(30.2)	(4.4)%	57.3	6.8%	(87.5)	(152.7)%
Interest expense, net	(42.8)	(6.2)%	(17.7)	(2.1)%	(25.1)	141.8%
Foreign currency gain (loss), net	(4.7)	(0.7)%	5.4	0.6%	(10.1)	(187.0)%
Others	—	—	1.1	0.1%	(1.1)	(100.0)%
Income (loss) before income taxes	(77.7)	(11.3)%	46.1	5.4%	(123.8)	(268.5)%
Income tax expenses (benefit)	0.3	0.0%	2.8	0.3%	(2.5)	(89.3)%
Net income (loss)	\$ (78.0)	(11.3)%	\$ 43.3	5.1%	\$(121.3)	(280.1)%

*Net Sales.* Net sales for nine-month period ended October 2, 2005 were \$692.5 million. This represents a \$149.1 million or 17.7% decrease compared to \$841.6 million for the nine-month period ended September 30, 2004. This decrease in net sales is primarily attributable to a reduction in DRAM foundry revenue from Hynix and revenue from our application processor product line. As mentioned previously, we have realigned these products to focus on consumer appliance and mobile application areas where our strategic and technical strength can be leveraged and is more consistent with our core business.

During the nine months ended October 2, 2005, revenues from our core business declined by \$6.3 million primarily due to higher display solutions revenues from higher market demand being more than offset by declines in our CMOS imaging solution business and semiconductor manufacturing services. The decrease in CMOS imaging solution revenues was due to the decrease in average selling price. The decrease in semiconductor manufacturing services revenues was attributable to lower volume coupled with a decline in average selling price.

Net sales to related parties for the current period decreased by \$163.8 million from the prior-year period. Subsequent to the Acquisition date, all sales made to Hynix were not reflected as Related Party sales. We do not break out sales to Hynix as an independent company. During the nine-month period ended October 2, 2005, net sales to others were \$692.5 million, a \$14.7 million or 2.2% increase from the nine-month period ended September 30, 2004.

*Cost of Sales.* Cost of sales were \$544.2 million for the nine-month period ended October 2, 2005, a \$110.4 million or 16.9% decrease from \$654.6 million in the prior-year period. The decrease in cost of sales was attributable to lower revenue and reduced depreciation expense, which is attributable to the Acquisition. Also included in cost of sales in the current-year period was \$4.5 million in amortization of the fair market value of inventory in conjunction with the valuation of assets in purchase accounting resulting from the Acquisition. Cost of sales as a percentage of net sales was 78.6% for the nine-month period compared to 77.8% for the prior-year period primarily due to higher variable costs, partially offset by reduction in depreciation expense.

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*Selling, General and Administrative Expenses.* Selling, general and administrative expenses were \$89.2 million or 12.9% of net sales for the nine-month period ended October 2, 2005, a \$35.2 million or 65.2% increase from the prior-period selling, general and administrative expenses of \$54.0 million or 6.4% of net sales. The increase in SG&A expenses was primarily attributable to increased amortization costs due to purchase accounting resulting from the Acquisition as well as increased professional fees, partially offset by reduced stock option expenses.

*Research and Development Expenses.* Research and development expenses were \$80.6 million for the nine-month period ended October 2, 2005, a \$4.9 million or 6.5% increase compared to \$75.7 million for the nine-month period ended September 30, 2004. This increase was primarily attributable to increased labor costs, resulting from the addition of senior engineering headcount from the acquisitions of ISRON Corporation and IC Media Corporation coupled with improved development tools and associated maintenance contracts. Research and development expenses as a percentage of net sales for current-year period was 11.6% compared to 9.0% in the prior-year period.

*Restructuring and Impairment Charges.* During the current year period, the Company recorded a one-time charge of \$8.7 million for restructuring and asset impairment. This amount included \$8.0 million for long-lived asset impairment and \$0.7 million for an early retirement program. Refer to Note 9. Restructuring and Impairment Charges for details.

*Operating Income (Loss).* Operating loss for the nine-month period ended October 2, 2005 was \$30.2 million, an \$87.5 million decrease from the operating income of \$57.3 million for the nine-month period ended September 30, 2004. Operating loss as a percentage of net sales was 4.4% in current-year period compared to operating income as a percentage of net sales of 6.8% in the same period during 2004. The current period operating loss was primarily attributable to a decrease in net sales due to a realignment of our businesses and an increase in our operating expenses which included higher intangible amortization resulting from the Acquisition, professional fees and one-time charges mentioned above.

*Net Interest Expense.* Net interest expense was \$42.8 million during the nine-month period ended October 2, 2005, a \$25.1 million or 141.8% increase from \$17.7 million for the nine-month period ended September 30, 2004. The increase in net interest expense was primarily due to the resulting interest expense associated with the outstanding long-term debt of \$750.0 million in the current year period versus \$249.1 million in long-term debt on a carve-out basis at September 30, 2004. Refer to Note 4. Short-term and Long-term Borrowings for details.

*Income Tax Expense (Benefit).* Income tax expense was \$0.3 million for the nine-month ended October 2, 2005, a \$2.5 million decrease from \$2.8 million for the nine-month period ended September 30, 2004. Income tax expense of current year period was principally attributable to the effect of the Korean withholding tax on the interest income paid to our Korean subsidiary's parent company that was mostly offset by the recognition of a deferred tax asset for expected future utilization of the Company's cumulative tax net operating loss. Due to the uncertainty of utilization for foreign tax credits, the Korean withholding tax was treated as a current tax expense to the Company.

### **Liquidity and Capital Resources**

Our principal capital requirements are to fund working capital needs, meet required debt payments, including debt service payments on the notes and, if drawn upon, the senior credit facility, to invest in research and development and capital expenditures. We anticipate that operating cash flow, together with available borrowing capacity under our senior credit facility, will be sufficient to meet our working capital needs, our research and development and capital expenditures and service requirements on our debt obligations for the foreseeable future. As of October 2, 2005 we had total long-term debt outstanding of \$750.0 million.

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We generated cash from operating activities of \$57.2 million and \$312.2 million for the nine-month periods ended October 2, 2005 and September 30, 2004, respectively. The decrease in cash from operating activities between the two periods was primarily due to a 20.7% decrease in gross profit and a 26.5% increase in operating expense on a cash basis.

Our working capital balance as of October 2, 2005 was \$128.0 million compared to \$129.3 million as of December 31, 2004. Increases in accounts payable and short-term borrowings resulting from higher capital equipment purchases during the nine-month period ended October 2, 2005 were mostly offset by an increase in accounts receivable.

Investing activities included cash outlays of approximately \$46.9 million and \$85.3 million for the nine-month periods ended October 2, 2005 and September 30, 2004, respectively. The decrease in cash used for investing activities was due to lower expenditures on plant, property and equipment year over year, partially offset by an increase in cash spent on business acquisitions in the current year.

We used \$1.9 million during the nine-month period ended October 2, 2005 and \$226.8 million for nine-month period ended September 30, 2004 for financing activities. In the current year, the Company repaid short-term borrowings of \$12.4 million and obtained short-term borrowings of \$10.6 million. In the prior year, the Company repaid short-term and long-term borrowings in the amounts of \$46.9 million and \$179.9 million, respectively.

*Capital Expenditures.* For the nine-month period ended October 2, 2005, capital expenditures totaled \$41.5 million compared to \$86.7 million during the nine-month period ended September 30, 2004. The year over year decrease was due to management of the timing of capital expenditures, to balancing demand of new and existing businesses and to optimizing returns on investment.

*Future Financing Activities.* Our primary future capital requirements on a recurring basis will be funding working capital needs, meeting required debt payments, funding research and development, and capital expenditures. Going forward, we expect to make investments in advanced software and hardware design tools that increase our design engineer productivity. In addition, we plan to add design centers in key geographical locations near our strategic customers. We anticipate that operating cash flows, together with available borrowings under our senior credit facility, will be sufficient to meet these capital requirements for the foreseeable future. We may from time to time incur additional debt.

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### Contractual Obligations

Summarized in the table below are our obligations and commitments to make future payments under debt obligations and minimum lease payment obligations as of October 2, 2005.

	Payments Due by Period						Interest expense
	Total	2005	2006	2007	2008	2009	
	<i>(in millions of US Dollars)</i>						
Revolving credit facility (*)	11.1		11.1				
Secured notes and subordinated notes(*)	750.0						750.0
Operating lease	16.4	1.6	5.5	4.5	2.4	2.4	
Others	11.2	1.6	4.9	4.6	0.1		0.8
							(0.8)

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

### Unit/Stock-based Compensation Expense

For options granted to employees on or after October 6, 2004, we record a compensation charge equal to the excess, if any, of the deemed fair value of the stock at the measurement date over the option exercise price, in accordance with Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*. All of the option grants during this period reflected an exercise price equal to or higher than the fair value, therefore, no compensation expense was recorded. Refer to Note 8, Unit-Based Compensation for details.

Options were previously granted by Hynix to our employees and the related compensation costs are reflected in the historical financials. For the three months ended September 30, 2004, \$0.5 million was reversed out from previously recorded expenses primarily as a result of changes in market value of Hynix common stock, whereas \$3.3 million was recorded as expense for the nine months ended September 30, 2004. None of these options were transferred as part of the Acquisition, and therefore, no additional future charges will be required related to these previously issued option grants. We have established a new employee option plan and intend to make grants in the future.

### Recent accounting pronouncements

In December 2004, FASB issued SFAS 123(R), *Share-Based Payment (revised 2004)*. This revision will affect current practice in a number of ways, including the elimination of the alternative to use the intrinsic value method of accounting from Accounting Principles Board ("APB") Opinion No. 25 that was provided in FASB Statement No. 123 as originally issued. Pursuant to this statement, companies are required to record stock option expense in its financial statements based on a fair value methodology. This statement will become effective and impact the Company on January 1, 2006. The Company is currently evaluating the impact of this proposed FASB Statement on its financial statements.

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In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*, an amendment of ARB No. 43, Chapter 4. This Statement amends the guidance in Accounting Research Bulletin (“ARB”) No. 43, Chapter 4, *Inventory Pricing*, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), and requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The effective date for the Company was January 1, 2005, and there was no material impact on our financial statements resulting from this proposed FASB Statement.

In May 2005, the FASB issued SFAS 154, *Accounting Changes and Error Corrections* – a replacement of APB Opinion No. 20 and FASB Statement No. 3. This Statement supersedes APB Opinion No. 20, *Accounting Changes* and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, and changes the requirements for the accounting and reporting for a change in accounting principle. This statement requires retrospective application to prior periods’ financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This standard is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of this standard will have no impact on our financial statements. To our knowledge, no accounting changes or errors have occurred in the current or prior periods.

### **Certain Factors**

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

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

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

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

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

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

We generally do not obtain firm, long-term purchase commitments from our customers. Customers may cancel their orders, change production quantities or delay production for a number of reasons. Cancellations, reductions or delays by a significant customer or by a group of customers, which we have experienced as a result of the recent downturn in the semiconductor industry, have adversely affected and may continue to adversely affect our results of operations. In addition, while we do not obtain long-term purchase commitments, we generally agree to the pricing of a particular product for the entire lifecycle of the product, which can extend over a number of years. If we underestimate our costs when determining the pricing, our margins and results of operations would be adversely affected.

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

If we were to lose key customers or if customers cease to place orders for our high volume devices, our financial results will be adversely affected. While we served more than 190 customers in the nine-month period ended October 2, 2005, net sales to our 10 largest customers represented approximately 63.5% of our net revenue for the period. We had one customer representing greater than 10% of our revenue during the quarter ended October 2, 2005. Significant reductions in sales to any of these customers, the loss of major customers or the curtailment of orders for our high-volume devices within a short period of time would adversely affect our business.

**Our industry is highly competitive.**

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

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

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

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

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

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

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

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

We depend on our ability to attract and retain skilled technical and managerial personnel. Generally, with the exception of certain key executives, our employees are not bound by employment or noncompetition agreements. We could lose the services of, or fail to recruit, skilled personnel, which could hinder our research and product development programs or otherwise have a material adverse effect on our business.

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

As of October 2, 2005, approximately 60% of our employees were represented by the MagnaChip Semiconductor Labor Union, which is a member of the Federation of Korean Metal Workers Trade Unions. We cannot assure you that issues with the labor union and other employees will be resolved favorably for us in the future, that we will not experience significant work stoppages in future years or that we will not record significant charges related to those work stoppages.

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

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

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

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

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

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

**We rely on certain subcontractors.**

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

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

We use a wide range of parts and materials in the production of our semiconductors, including silicon, processing chemicals, processing gases, precious metals and electronic and mechanical components. We procure materials and electronic and mechanical components from domestic and foreign sources and original equipment manufacturers. As a division of Hynix, we were able to take advantage of Hynix's size and purchasing power in procuring parts and materials. As an independent company, we are smaller and less diversified than Hynix, and we may be unable to obtain parts and materials at prices and on terms as favorable as those available to us prior to the separation from Hynix in October 2004. If we cannot obtain adequate materials in a timely manner or on favorable terms for the manufacture of our products, either or both of our revenues or profits will decline.

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

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

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

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

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

Our ability to compete successfully depends on our ability to operate without infringing the proprietary rights of others. We have no means of knowing what patent applications have been filed in the United States until they are published. In addition, the semiconductor industry is characterized by frequent litigation regarding patent and other intellectual property rights. Although we have never received any notices of infringement of a third-party patent, to our knowledge, Hynix has received five notices of infringement from third parties regarding various technology transferred to us in the Acquisition. We cannot assure you that these or other third parties will not tender notices of patent infringement or assert infringement claims against us in the future. Litigation, which could result in substantial costs to us and diversion of our resources, may also be necessary to enforce our patents or other intellectual property rights or to defend against claimed infringement of the rights of others. In the event of an adverse outcome in any such litigation, we may be required to pay substantial damages, indemnify customers for damages they may suffer if the products they purchase from us violate the intellectual property rights of others, stop our manufacture, use, sale or importation of infringing products, expend significant resources to develop or acquire non-infringing technologies, discontinue processes or obtain licenses to the intellectual property we are found to have infringed. We cannot assure you that we would be successful in such development or acquisition or that such licenses would be available under reasonable terms, or at all.

As a business segment of Hynix, we were the beneficiary of some of Hynix's intellectual property arrangements, including cross-licensing arrangements with other leading semiconductor companies and licenses from third parties of technology incorporated in our products and used to operate our business. We are no longer a beneficiary under some of these agreements and arrangements. There may be third parties who had refrained from asserting intellectual property infringement claims against our products or processes while we were a business segment of Hynix that elect to pursue such claims against us now that we are an independent



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company. In addition, some of our technologies have been sublicensed from Hynix on a non-exclusive basis and Hynix may sublicense such technologies to others. We have cross-licensed most of our technologies to Hynix. This cross-license is subject to the non-competition provision of the Hynix business transfer agreement. Our competitors may develop, patent or gain access to similar know-how and technology. Failure to protect our existing intellectual property rights may result in the loss of valuable technologies or having to pay other companies for infringing on their intellectual property rights.

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

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

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

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

### **A limited number of persons indirectly control us and may exercise their control in a manner adverse to your interests.**

CVC, Francisco Partners, and CVC Asia Pacific, own approximately 34%, 34% and 18%, respectively, of the outstanding voting interests in MagnaChip LLC. By virtue of their ownership of these voting interests, and the securityholders' agreement among MagnaChip LLC and its unitholders, these entities have significant influence over our management and will be able to determine the outcome of all matters required to be submitted to the unitholders for approval, including the election of a majority of our directors and the approval of mergers, consolidations and the sale of all or substantially all of our assets.

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

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

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

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

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

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

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

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

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

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

**We depend on Hynix for services and our business and results of operations could be adversely affected if Hynix were unwilling or unable to provide such services or terminated the relationship.**

Pursuant to agreements we entered into at the time we acquired our business, a number of services that are essential to our business are provided to us by or through Hynix. Some of these services include electricity, bulk gasses and de-ionized water, campus facilities, wastewater and sewage management and environmental safety and facility monitoring services. If any of our agreements with Hynix were terminated or if Hynix were unwilling or unable to fulfill its obligations to us under the terms of these agreements, we may experience a material decrease in our production capabilities and increase in our expenses.

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

**Third parties may seek to hold us responsible for liabilities of Hynix that we did not assume in connection with the Acquisition of our business from Hynix.**

Third parties may seek to hold us responsible for Hynix's retained liabilities. Under our agreements with Hynix, Hynix has agreed to indemnify us for claims and losses relating to such retained liabilities. However, if such liabilities are significant and we are ultimately held liable for them, we cannot assure you that we will be able to recover the full amount of our losses from Hynix.

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

We invest significant resources in our research and development. However, research and development efforts may not yield commercially viable products. During each stage of research and development there is a substantial risk that we will have to abandon a

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potential product which is no longer marketable and in which we have invested significant resources. In the event we are able to develop viable new products, a significant amount of time will have elapsed between our investment in the necessary research and development effort and the receipt of any related revenues.

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

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

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

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

*Foreign Currency Risk.* We have exposure to some foreign currency exchange-rate fluctuations on net income from our subsidiaries denominated in currencies other than U.S. dollars. We have foreign subsidiaries in Korea, Taiwan, China, Japan and Hong Kong. From time to time these subsidiaries have cash and financial instruments in local currency. The amounts held in Japan, Taiwan, Hong Kong and China are not material in regards to foreign currency movements. However, based on the cash and financial instruments balance at October 2, 2005 for our Korean subsidiary, a 10% devaluation of the Korean Won against the U.S. dollar would have resulted in a decrease of \$3.2 million in our U.S. dollar financial instruments balance and cash balance.

*Interest Rate Risk.* The \$200 million 6<sup>7</sup>/<sub>8</sub>% Second Priority Senior Secured Notes due 2011 and the \$250 million 8% Senior Subordinated Notes due 2014 are subject to changes in fair value due to interest rate changes. If the market interest rate had decreased by 10% and all other variables were held constant from their levels at October 2, 2005, we estimate that we would have additional interest expense cost over market rate of \$2.0 million (270 days basis). Our net loss for nine-month period ended October 2, 2005 would have increased by 2.6%. The fair value on these fixed rate notes would have decreased by \$10.5 million or increased by \$11.0 million with a 10% increase or decrease in the interest rate, respectively.

*Cash Flow Interest Rate Risk.* During the current year, the Company entered into an interest rate swap agreement to convert the variable interest rate on our Floating Rate Second Priority Senior Secured Notes to a fixed interest rate for the periods to maturity date of June 2008. By this interest rate swap, cash flow interest rate risk was replaced with exposure to interest rate risk. Refer to Interest Swap under Note 4. Short-term and Long-term Borrowings for details.

**Item 4. Controls and Procedures**

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

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

During the quarterly period covered by this report, there were no changes in the Company’s internal controls over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company’s internal controls over financial reporting.

**Limitations on Controls:** Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures will prevent or detect all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**PART II OTHER INFORMATION**

**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.

**SIGNATURE**

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

MAGNACHIP SEMICONDUCTOR LLC

Dated: November 14, 2005

By: /s/ Youm Huh

Youm Huh

Chief Executive Officer and President

Dated: November 14, 2005

By: /s/ Robert J. Krakauer

Robert J. Krakauer

Executive Vice President, Strategic Operations  
and Chief Financial Officer

INDEX TO EXHIBITS

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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.

**CERTIFICATION BY CHIEF EXECUTIVE OFFICER**

I, Youm Huh, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MagnaChip Semiconductor LLC;
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(s) 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)) 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) 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
  - (c) 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.
5. The registrant's other certifying officer(s) 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.

Date: November 14, 2005

/s/ Youm Huh

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Youm Huh

Chief Executive Officer and President



**CERTIFICATION BY CHIEF FINANCIAL OFFICER**

I, Robert J. Krakauer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MagnaChip Semiconductor LLC;
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(s) 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)) 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) 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
  - (c) 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.
5. The registrant's other certifying officer(s) 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.

Date: November 14, 2005

/s/ Robert J. Krakauer

Robert J. Krakauer  
Executive Vice President, Strategic Operations, and Chief  
Financial Officer

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

In connection with the Quarterly Report of MagnaChip Semiconductor LLC (the "Company") on Form 10-Q for the period ending October 2, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Youm Huh, Chief Executive Officer and President of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Youm Huh

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Youm Huh

Chief Executive Officer and President

November 14, 2005

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

In connection with the Quarterly Report of MagnaChip Semiconductor LLC (the "Company") on Form 10-Q for the period ending October 2, 2005 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Robert J. Krakauer, Executive Vice President, Strategic Operations, and Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to §906 of the Sarbanes-Oxley Act of 2002, that to my knowledge:

- (1) The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Robert J. Krakauer

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Robert J. Krakauer

Executive Vice President, Strategic Operations, and Chief

Financial Officer

November 14, 2005

*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.*