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

FORM 10-Q

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

For the quarterly period ended September 30, 2014

or

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

For the transition period from _____ to _____.

Commission File Number: 001-34791

MagnaChip Semiconductor Corporation

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

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

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

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

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

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer (Do not check if a smaller reporting company)

Smaller reporting company

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

As of January 31, 2015, the registrant had 34,056,468 shares of common stock outstanding.

Explanatory Note

This Quarterly Report on Form 10-Q for the period ended September 30, 2014 (this “Quarterly Report”) is being filed by MagnaChip Semiconductor Corporation (“we,” “our,” “us,” the “Company,” or “MagnaChip”) concurrently with the filing of the Company’s Annual Report on Form 10-K for the year ended December 31, 2013, which was filed with the Securities and Exchange Commission (the “SEC”) on February 12, 2015 (the “2013 Form 10-K”). The 2013 Form 10-K contains audited financial statements of the Company for the years ended December 31, 2013, 2012 and 2011.

The Company filed a Current Report on Form 8-K with the SEC on March 11, 2014 disclosing the determination of the Audit Committee of the Company’s Board of Directors that certain of the Company’s previously issued annual audited and interim unaudited financial statements contained in its historical Annual Reports on Form 10-K and Quarterly Reports on Form 10-Q should no longer be relied upon.

In the 2013 Form 10-K, the Company restated and corrected the following financial statements of the Company (the “Restatement”): (i) the audited consolidated balance sheet as of December 31, 2012 and 2011, and consolidated statements of operations, comprehensive income, changes in stockholders’ equity and cash flows for each of the years ended December 31, 2012 and 2011; and (ii) the five-year selected financial data presented in the 2013 Form 10-K.

The 2013 Form 10-K was filed by the Company in lieu of the Company separately filing with the SEC amendments to its previously filed Annual Reports on Form 10-K for each of the years ended December 31, 2012 and 2011.

The unaudited financial statements for the three and nine months ended September 30, 2013 contained in this Quarterly Report are presented on a restated basis and are consistent with those contained in the 2013 Form 10-K. The Company has not separately amended, and does not intend to amend, its Quarterly Reports on Form 10-Q for the periods ended on or prior to September 30, 2013.

For more information on the matters that have led to the restatement and data previously reported, see “Note 2. Restatement of Consolidated Financial Statements” to our consolidated financial statements contained in the 2013 Form 10-K and our consolidated financial statements contained herein.

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PART I—FINANCIAL INFORMATION

Item 1. Interim Consolidated Financial Statements (Unaudited)

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Unaudited; in thousands of US dollars, except share data)

	September 30, 2014	December 31, 2013
Assets		
Current assets		
Cash and cash equivalents	\$ 125,210	\$ 153,606
Restricted cash	—	4
Accounts receivable, net	77,300	78,898
Inventories, net	76,694	74,698
Other receivables	5,622	6,011
Prepaid expenses	11,866	9,194
Current deferred income tax assets	586	1,348
Other current assets	7,695	10,403
Total current assets	<u>304,973</u>	<u>334,162</u>
Property, plant and equipment, net	249,893	254,297
Intangible assets, net	2,588	3,111
Long-term prepaid expenses	12,254	16,405
Deferred income tax assets	535	896
Other non-current assets	14,699	16,319
Total assets	<u>\$ 584,942</u>	<u>\$ 625,190</u>
Liabilities and Stockholders' Equity		
Current liabilities		
Accounts payable	\$ 74,529	\$ 75,059
Other accounts payable	16,058	15,670
Accrued expenses	77,395	65,494
Other current liabilities	5,213	5,872
Total current liabilities	<u>173,195</u>	<u>162,095</u>
Long-term borrowings, net	224,007	223,923
Accrued severance benefits, net	144,739	134,172
Other non-current liabilities	19,083	23,459
Total liabilities	<u>561,024</u>	<u>543,649</u>
Commitments and Contingencies (Note 17)		
Stockholders' equity		
Common stock, \$0.01 par value, 150,000,000 shares authorized, 40,635,128 shares issued and 34,056,363 outstanding at September 30, 2014 and 40,627,131 shares issued and 34,048,366 outstanding at December 31, 2013	406	406
Additional paid-in capital	117,954	116,222
Retained earnings	52,487	105,889
Treasury stock, 6,578,765 shares at September 30, 2014 and December 31, 2013	(90,918)	(90,918)
Accumulated other comprehensive loss	(56,011)	(50,058)
Total stockholders' equity	<u>23,918</u>	<u>81,541</u>
Total liabilities and stockholders' equity	<u>\$ 584,942</u>	<u>\$ 625,190</u>

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

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in thousands of US dollars, except share data)

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)	September 30, 2014	September 30, 2013 (As Restated)
Net sales	\$ 194,332	\$ 170,812	\$ 530,566	\$ 558,667
Cost of sales	151,702	136,399	412,202	420,778
Gross profit	42,630	34,413	118,364	137,889
Selling, general and administrative expenses	38,690	22,155	94,463	63,914
Research and development expenses	23,422	22,478	70,618	65,118
Restructuring and impairment charges	—	—	—	2,446
Operating income (loss)	(19,482)	(10,220)	(46,717)	6,411
Other income (expenses)				
Interest expense, net	(4,078)	(4,548)	(12,155)	(16,276)
Foreign currency gain (loss), net	(23,508)	47,115	5,510	1,512
Loss on early extinguishment of senior notes	—	(32,812)	—	(32,812)
Other	572	1,191	1,730	1,871
	(27,014)	10,946	(4,915)	(45,705)
Income (loss) before income taxes	(46,496)	726	(51,632)	(39,294)
Income tax expenses	311	475	1,770	2,712
Net income (loss)	\$ (46,807)	\$ 251	\$ (53,402)	\$ (42,006)
Earnings (loss) per common share				
Basic	\$ (1.37)	\$ 0.01	\$ (1.57)	\$ (1.18)
Diluted	\$ (1.37)	\$ 0.01	\$ (1.57)	\$ (1.18)
Weighted average number of shares				
Basic	34,056,359	35,443,820	34,055,210	35,485,395
Diluted	34,056,359	37,484,601	34,055,210	35,485,395

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

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(Unaudited; in thousands of US dollars)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>September 30,</u> <u>2014</u>	<u>September 30,</u> <u>2013</u> <u>(As Restated)</u>	<u>September 30,</u> <u>2014</u>	<u>September 30,</u> <u>2013</u> <u>(As Restated)</u>
Net income (loss)	\$ (46,807)	\$ 251	\$ (53,402)	\$ (42,006)
Other comprehensive income (loss)				
Foreign currency translation adjustments	16,874	(31,300)	(2,462)	(3,094)
Derivative adjustments				
Fair valuation of derivatives	(3,319)	16,102	2,882	4,281
Reclassification adjustment for gain on derivatives included in net income (loss)	(3,048)	(34)	(5,692)	(289)
Investment adjustments				
Unrealized gain on investments	—	45	1,201	540
Reclassification adjustment for gain on investments included in net income (loss)	—	—	(1,882)	—
Total comprehensive loss	<u>\$ (36,300)</u>	<u>\$ (14,936)</u>	<u>\$ (59,355)</u>	<u>\$ (40,568)</u>

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

MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
(Unaudited; in thousands of US dollars, except share data)

	Common Stock		Additional Paid-In Capital	Retained Earnings	Treasury Stock	Accumulated Other Comprehensive Loss	Total
	Shares	Amount					
Nine Months Ended September 30, 2014 Balance at January 1, 2014	<u>34,048,366</u>	<u>\$ 406</u>	<u>\$116,222</u>	<u>\$105,889</u>	<u>\$(90,918)</u>	<u>\$ (50,058)</u>	<u>\$ 81,541</u>
Stock-based compensation	—	—	1,665	—	—	—	1,665
Exercise of stock options	6,795	—	48	—	—	—	48
Exercise of warrants	1,202	—	19	—	—	—	19
Other comprehensive loss, net	—	—	—	—	—	(5,953)	(5,953)
Net loss	—	—	—	(53,402)	—	—	(53,402)
Balance at September 30, 2014	<u>34,056,363</u>	<u>\$ 406</u>	<u>\$117,954</u>	<u>\$ 52,487</u>	<u>\$(90,918)</u>	<u>\$ (56,011)</u>	<u>\$ 23,918</u>
Nine Months Ended September 30, 2013 Balance at January 1, 2013 (As Restated)	<u>35,635,357</u>	<u>\$ 396</u>	<u>\$102,409</u>	<u>\$170,092</u>	<u>\$(39,918)</u>	<u>\$ (41,450)</u>	<u>\$191,529</u>
Stock-based compensation	—	—	1,558	—	—	—	1,558
Exercise of stock options	542,746	5	4,049	—	—	—	4,054
Exercise of warrants	356,675	4	5,618	—	—	—	5,622
Acquisition of treasury stock	(1,589,401)	—	—	—	(31,000)	—	(31,000)
Other comprehensive income, net	—	—	—	—	—	1,438	1,438
Net loss	—	—	—	(42,006)	—	—	(42,006)
Balance at September 30, 2013 (As Restated)	<u>34,945,377</u>	<u>\$ 405</u>	<u>\$113,634</u>	<u>\$128,086</u>	<u>\$(70,918)</u>	<u>\$ (40,012)</u>	<u>\$131,195</u>

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

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MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands of US dollars)

	Nine Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Cash flows from operating activities		
Net loss	\$ (53,402)	\$ (42,006)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	22,846	24,976
Provision for severance benefits	14,775	15,782
Bad debt expenses	3,755	(47)
Amortization of debt issuance costs and original issue discount	457	744
Gain on foreign currency translation, net	(4,077)	(54)
Gain on disposal of investments	(1,524)	—
Restructuring and impairment charges	—	618
Stock-based compensation	1,665	1,558
Loss on early extinguishment of senior notes	—	32,812
Other	951	1,280
Changes in operating assets and liabilities		
Accounts receivable	(206)	12,490
Inventories, net	(1,199)	(922)
Other receivables	353	(1,454)
Other current assets	4,835	8,280
Deferred tax assets	835	1,591
Accounts payable	(964)	(3,278)
Other accounts payable	(7,265)	(6,172)
Accrued expenses	12,678	4,799
Other current liabilities	(201)	(4,857)
Other non-current liabilities	65	7,942
Payment of severance benefits	(4,712)	(4,331)
Other	19	(348)
Net cash provided by (used in) operating activities	<u>(10,316)</u>	<u>49,403</u>
Cash flows from investing activities		
Proceeds from disposal of investments	2,003	—
Purchase of plant, property and equipment	(15,613)	(40,593)
Payment for intellectual property registration	(778)	(401)
Payment of guarantee deposits	(338)	(941)
Other	45	345
Net cash used in investing activities	<u>(14,681)</u>	<u>(41,590)</u>
Cash flows from financing activities		
Proceeds from issuance of common stock	67	9,676
Proceeds from issuance of senior notes	—	218,836
Repayment of long term borrowings	—	(229,333)
Acquisition of treasury stock	—	(31,000)
Net cash provided by (used in) financing activities	67	(31,821)
Effect of exchange rates on cash and cash equivalents	(3,466)	38
Net decrease in cash and cash equivalents	<u>(28,396)</u>	<u>(23,970)</u>
Cash and cash equivalents		
Beginning of the period	153,606	182,238
End of the period	<u>\$ 125,210</u>	<u>\$ 158,268</u>
Supplemental cash flow information		
Cash paid for interest	<u>\$ 14,812</u>	<u>\$ 16,266</u>
Cash paid for income taxes	<u>\$ 743</u>	<u>\$ 6,217</u>
Non-cash investing activities		
Property, plant and equipment additions in other accounts payable	<u>\$ 396</u>	<u>\$ 57</u>

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

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements
(Unaudited; tabular dollars in thousands, except share data)

1. Business, Basis of Presentation and Significant Accounting Policies

Business

MagnaChip Semiconductor Corporation (together with its subsidiaries, the “Company”) is a Korea-based designer and manufacturer of analog and mixed-signal semiconductor products for high-volume consumer, computer and communication applications. The Company’s business is comprised of three key business lines: Display Solutions, Power Solutions and Semiconductor Manufacturing Services. The Company’s Display Solutions products include display drivers for use in a wide range of flat panel displays and mobile multimedia devices. The Company’s Power Solutions products include discrete and integrated circuit solutions for power management in high-volume consumer, computer, communication and industrial applications. The Company’s Semiconductor Manufacturing Services provide specialty analog and mixed-signal foundry services for fabless semiconductor companies that serve the consumer, computing and wireless end markets.

Basis of Presentation

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles in the United States of America (“US GAAP”). These interim consolidated financial statements include normal recurring adjustments and the elimination of all intercompany accounts and transactions which are, in the opinion of management, necessary to provide a fair statement of the Company’s financial condition and results of operations for the periods presented. These interim consolidated financial statements are presented in accordance with ASC 270, “*Interim Reporting*,” (“ASC 270”) and, accordingly, do not include all of the information and note disclosures required by US GAAP for complete financial statements. The results of operations for the three and nine months ended September 30, 2014 are not necessarily indicative of the results to be expected for a full year or for any other periods.

The December 31, 2013 balance sheet data was derived from the Company’s audited financial statements, but does not include all disclosures required by US GAAP.

Recent Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, “Presentation of Financial Statements – Going Concern” (“ASU 2014-15”), which provides guidance on determining when and how to disclose going-concern uncertainties in the financial statements. ASU 2014-15 requires management to perform interim and annual assessments of an entity’s ability to continue as a going concern within one year of the date the financial statements are issued. An entity will be required to provide certain disclosures if conditions of events raise substantial doubt about the entity’s ability to continue as a going concern. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. The Company is currently evaluating the impact of the adoption of ASU 2014-15 on its consolidated financial statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-11, “Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures” (“ASU 2014-11”). The guidance in this update changes the accounting for repurchase-to-maturity transactions and repurchasing financing arrangements. It also requires enhanced disclosures about repurchase agreements and other similar transactions. The accounting changes in this update are effective for public companies for the first interim or annual period beginning after December 15, 2014. In addition, for public companies, the disclosure for certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early application is not permitted. The Company is currently evaluating the impact of the adoption of ASU 2014-11 on its consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09, “Revenue from Contracts with Customers” (“ASU 2014-09”). ASU 2014-09 supersedes the revenue recognition requirements in “Revenue Recognition (Topic 605)”, and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. The Company is currently evaluating the impact of the adoption of ASU 2014-09 on its consolidated financial statements.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

2. Restatement of Consolidated Financial Statements

These interim financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2013 contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013 (the "2013 Form 10-K"), which was filed on February 12, 2015.

Background and Scope of Investigation

In January 2014, the Audit Committee of the Company's Board of Directors (the "Audit Committee") commenced an internal investigation into the Company's accounting practices and procedures with outside professional advisors (the "Independent Investigation"). The Independent Investigation involved procedures that included forensic analysis and inquiry directed to aspects of the Company's accounting and financial reporting practices, and evaluated aspects of its historical accounting and financial reporting practices since 2011. The Independent Investigation initially raised questions relating to numerous accounting transactions, most of which involved revenue recognition practices relating to distributor relationships.

Based on initial findings and observations from the Independent Investigation regarding errors in the Company's revenue recognition practices related to sales through distributors, the Company announced on March 11, 2014 that the Audit Committee concluded that the Company's previously issued financial statements for each of the years ended December 31, 2012 and December 31, 2011 and the quarters ended March 31, June 30 and September 30 in 2013 and 2012 should no longer be relied upon.

The Independent Investigation continued through October 2014 and identified numerous accounting errors, most of which involved revenue recognition, cost of goods sold, inventory reserves, fixed asset capitalization, and expense recognition and allocation. It also identified deficiencies regarding business practices related to distributors, non-distributor customers and vendors. Concurrently with the Independent Investigation, management conducted extensive internal review of its financial accounting and reporting practices and internal control over financial reporting. The Independent Investigation and management's internal review identified evidence of errors in the Company's accounting and deficiencies in its internal control over financial reporting.

Restatement Adjustments

As a result of the issues identified in the Independent Investigation and management's internal review, the Company restated its previously reported consolidated financial statements for the three and nine months ended September 30, 2013 in order to correct certain previously reported amounts.

The impact of the errors to the previous statements of operations, statement of cash flows and statements of comprehensive income has been detailed in the tables below. A description of the nature of the errors follows.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

Revenue Recognition

Sales through Distributors — The largest portion of revenue recognition adjustments relate to correcting the timing and amount of revenue recognized on the sale of products through certain distributors. During the course of the Independent Investigation and management's internal review, it was determined that the application of its revenue recognition policy was not appropriate in these situations. Revenue had been recognized without persuasive evidence of an arrangement and the collectability of the sales price not being reasonably assured. Furthermore, in some circumstances, revenue was recognized prior to risk of loss being transferred.

Accordingly, related revenues and cost of sales were reversed in the period in which the accounting errors took place and recognized in subsequent periods when all of the revenue recognition criteria were met. These adjustments also include the impact of foreign currency exchange rate differences between periods of de-recognition and recognition of the revenue transactions.

Other — The other revenue recognition adjustments include transactions where the Company recognized revenue in an incorrect period or recognized an incorrect amount of revenue. The primary categories of other revenue recognition adjustments include the following:

- **Unfinished Products** — The Company identified recognition of revenues on unfinished or semi-finished products. These products were completed and shipped to the distributor or end customer after the related revenues were recognized.
- **Gross to Net** — The Company identified foundry service transactions in which the related wafers were provided by the customer. The revenue and cost related to such wafers were recognized on a gross basis when they should have been recognized on a net basis.
- **Cut-off** — The Company identified certain sales transactions that were recognized prior to the transfer of inventory risk and title.
- **Non-recurring Engineering ("NRE")** — The Company provides NRE services to develop prototype wafers mainly for the Company's foundry service customers. The Company identified revenue related to certain NRE arrangements recognized earlier or later than at the time that the required prototype wafer was delivered.
- **Concessions** — The Company identified various types of unrecorded concessions provided to its distributors and customers, including future discounts, price adjustments, return rights, free products and others to incentivize distributors and customers to make purchases. Such concessions should be recorded as a deduction from revenues at the time when the related revenues are recognized.
- **Direct Customer Sales** — The Company identified certain sales transactions to a customer that were recognized when the products were taken from the Company's manufacturing facility to its warehouse, rather than when the products were delivered to the customer's location. The arrangement related to these transactions did not have a fixed schedule for delivery to a customer's location and were prematurely recognized as revenues.

Hedge Accounting — As a result of incorrect recognition of revenue discussed in *Revenue Recognition – Sales through Distributors* and *Revenue Recognition – Other*, the Company's hedge accounting, related to the change in the effective portion of our derivative instrument's gains and losses, was adjusted as key assumptions determining the amount are derived from revenues.

Reserves — As a result of incorrect recognition of revenue discussed in *Revenue Recognition – Sales through Distributors* and *Revenue Recognition – Other*, adjustments for reserves, related to estimated refunds, low yield compensation, and warranty liabilities, also required corrections as key assumptions in determining these amounts are derived from revenues.

Manufacturing Cost — The Company corrected certain fabrication and back-end processing costs that were not recorded consistently with the progression of its manufacturing activities. As a result, the Company's cost of sales was decreased by approximately \$800 thousand and approximately \$6,500 thousand for the three and nine months ended September 30, 2013, to account for manufacturing costs during the period in which they were incurred.

Inventory Reserves

The Company corrected errors with respect to how the Company previously forecasted revenues for the purposes of determining inventory reserves. As a result, the Company performed a retrospective review of its inventory reserve calculation and revised the revenue forecast component of the reserve calculation. In addition, as a result of the correction of revenue for certain transactions discussed in *Revenue Recognition – Sales through Distributors* and *Revenue Recognition – Other*, a significant portion of the revenues were reversed rather than deferred. The failure of the anticipated orders from final customers materializing resulted in a significantly higher excess and obsolete reserves for the restatement and subsequent periods. In addition, the Company corrected errors with respect to obsolete and aged inventory reserves that were previously understated due to the misclassification or errors in certain inventory items.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

Understated Employee Benefits

The Company identified that certain amounts of earned vacation that were not included in calculating its severance accrual, resulting in an understatement of accrued severance benefits.

The Company also identified that vested compensation claims by employees who have rendered long-term services were accounted for on a cash basis rather than on an accrual basis, resulting in an understatement of long-term service liabilities.

Settlement Obligations

The Company identified certain cash and in-kind payments to one customer since 2011 and in-kind payments to another customer since the second quarter of 2013. These payments relate to settling claims involving the Company's product that may have caused a failure in the customer's product. Although the Company does not agree with these claims, as its product met the customers' specifications, the Company considered a number of factors and decided not to dispute these claims but make certain cash and/or in-kind payments as demanded by the customers. A number of cash and in-kind payments were recorded as cost of sales and/or reduction of revenues at the time that they were paid rather than accrued when each cash or in-kind payment became probable.

Tax Matters

Income Tax — Realization of the deferred tax assets is dependent on the Company's ability to generate future taxable income. In the previously reported consolidated financial statements for the year ended December 31, 2012, the Company had released \$64,749 thousand of valuation allowance against deferred tax assets of the Company's Korean subsidiary and, consequently, a corresponding amount of income tax benefit was recognized.

During the management's internal review, key assumptions and forecast of future taxable income were reassessed based on restated financial data as to whether deferred tax assets will ultimately be realized. In its reassessment, the Company concluded that the objective and verifiable negative evidence represented by recent actual operating losses outweighed more subjective positive evidence of anticipated future income over the periods in which the deferred tax assets are deductible. As a result, the Company determined that it was necessary to record a full valuation allowance on deferred tax assets of \$64,749 thousand as of December 31, 2012 and for each subsequent quarter thereafter. The related expense was recorded in the Company's statement of operations for the year ended December 31, 2012 as an income tax expense. In addition, the management's review identified income tax adjustments attributable to certain foreign subsidiaries other than Korea and made an adjustment amounting to \$112 thousand.

The restatement adjustments for the three and nine months ended September 30, 2013 impacted our temporary differences between our book income and taxable income, which resulted in an increase of our deferred tax assets for which a full valuation allowance was recorded for the fiscal periods then ended and thus there was no tax impact of the other restatement adjustments.

Other — The Company identified liabilities related to non-income-based taxes that the Company may be exposed to in connection with certain tax positions taken. We considered the period in which the underlying cause of action occurred, degree of probability of an unfavorable outcome and whether we could make a reasonable estimate.

Maintenance Costs

The Company identified certain maintenance expenses that were inappropriately capitalized and depreciated. As a result, the Company corrected these errors by reversing the related amounts in property, plant and equipment, and recorded them in cost of sales and research and development expense. In addition, the Company identified certain cash payments to a maintenance supplies vendor, that (i) the vendor used to purchase products from distributors; (ii) the distributors then paid to the Company for those products; and (iii) in turn were applied to the Company's aged accounts receivable.

Account Classification

Revenue — The Company corrected the classification of rental income that was previously recorded as net sales when it should have been recorded in other income (expenses).

Expense — The Company identified errors in classification of expenses that were recorded as cost of sales when they should have been recorded as research and development for the three and nine months ended September 30, 2013.

Cost Center Allocation

The Company identified costs from certain cost centers that were not always allocated consistently with the nature of the Company's business. As a result, the Company recorded adjustments to reclassify the related costs from cost of sales to selling, general and administrative expenses.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

Other Adjustments

In addition to the restatement adjustments described above, the Company has identified other errors that are not material, individually or in the aggregate, but have been recorded in connection with the restatement.

Included in other adjustments are as follows:

- *Accrued Liabilities* — The Company identified costs related to certain goods and services that were recorded at the time of receipt of invoice rather than when the goods were delivered or services were rendered. As a result, the Company recorded adjustments to cost of sales and research and development expense.
- *Stock-based Compensation* — The Company identified incorrect application of assumptions in computation of stock-based compensation expenses. As a result, the Company recorded adjustments to increase compensation expenses.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

The following table presents the impact of the restatement adjustments on the Company's previously reported consolidated statement of operations for the three months ended September 30, 2013:

	Three Months Ended September 30, 2013											
	As Previously Reported	Restatement Adjustments										As Restated
Revenue Recognition		Inventory Reserves	Understated Employee Benefits	Settlement Obligations	Tax Matters	Maintenance Cost	Cost Center Allocation	Account Classification	Other Adjustments	Total Adjustments		
Net sales	\$ 217,824	\$ (46,474)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (538)	\$ —	\$ (47,012)	\$ 170,812
Cost of sales	145,936	(26,884)	17,825	14	(1,412)	—	2,328	(834)	(671)	97	(9,537)	136,399
Gross profit	71,888	(19,590)	(17,825)	(14)	1,412	—	(2,328)	834	133	(97)	(37,475)	34,413
Selling, general and administrative expenses	20,071	(173)	—	(18)	—	1,371	—	870	—	34	2,084	22,155
Research and development expenses	21,192	—	—	32	—	—	118	(36)	671	501	1,286	22,478
Operating income (loss)	30,625	(19,417)	(17,825)	(28)	1,412	(1,371)	(2,446)	—	(538)	(632)	(40,845)	(10,220)
Other income (expenses)												
Interest expense, net	(4,548)	—	—	—	—	—	—	—	—	—	—	(4,548)
Foreign currency gain, net	43,350	3,763	—	—	—	—	—	—	—	2	3,765	47,115
Loss on early extinguishment of senior notes	(32,812)	—	—	—	—	—	—	—	—	—	—	(32,812)
Others	763	(110)	—	—	—	—	—	—	538	—	428	1,191
	6,753	3,653	—	—	—	—	—	—	538	2	4,193	10,946
Income before income taxes	37,378	(15,764)	(17,825)	(28)	1,412	(1,371)	(2,446)	—	—	(630)	(36,652)	726
Income tax expenses (benefits)	(9,293)	—	—	—	—	9,768	—	—	—	—	9,768	475
Net income	\$ 46,671	\$ (15,764)	\$ (17,825)	\$ (28)	\$ 1,412	\$ (11,139)	\$ (2,446)	\$ —	\$ —	\$ (630)	\$ (46,420)	\$ 251
Earnings per common share—												
Basic	\$ 1.32											\$ 0.01
Diluted	\$ 1.24											\$ 0.01
Weighted average number of shares—												
Basic	35,443,820											35,443,820
Diluted	37,493,550											37,484,601

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

The following table presents the impact of the restatement adjustments on the Company's previously reported consolidated statement of operations for the nine months ended September 30, 2013:

	Nine Months Ended September 30, 2013											
	As Previously Reported	Restatement Adjustments										As Restated
Revenue Recognition		Inventory Reserves	Understated Employee Benefits	Settlement Obligations	Tax Matters	Maintenance Cost	Cost Center Allocation	Account Classification	Other Adjustments	Total Adjustments		
Net sales	\$ 638,411	\$ (78,089)	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ (1,655)	\$ —	\$ (79,744)	\$ 558,667
Cost of sales	429,732	(48,402)	28,021	196	10,149	—	5,653	(2,559)	(1,683)	(329)	(8,954)	420,778
Gross profit	208,679	(29,687)	(28,021)	(196)	(10,149)	—	(5,653)	2,559	28	329	(70,790)	137,889
Selling, general and administrative expenses	59,571	(422)	—	28	—	1,995	—	2,627	—	115	4,343	63,914
Research and development expenses	62,905	—	—	105	—	—	189	(68)	1,683	304	2,213	65,118
Restructuring and impairment charges	2,446	—	—	—	—	—	—	—	—	—	—	2,446
Operating income	83,757	(29,265)	(28,021)	(329)	(10,149)	(1,995)	(5,842)	—	(1,655)	(90)	(77,346)	6,411
Other income (expenses)												
Interest expense, net	(16,276)	—	—	—	—	—	—	—	—	—	—	(16,276)
Foreign currency gain, net	(186)	1,674	—	—	—	—	—	—	—	24	1,698	1,512
Loss on early extinguishment of senior notes	(32,812)	—	—	—	—	—	—	—	—	—	—	(32,812)
Others	273	(57)	—	—	—	—	—	—	1,655	—	1,598	1,871
	(49,001)	1,617	—	—	—	—	—	—	1,655	24	3,296	(45,705)
Income (loss) before income taxes	34,756	(27,648)	(28,021)	(329)	(10,149)	(1,995)	(5,842)	—	—	(66)	(74,050)	(39,294)
Income tax expenses (benefits)	(8,946)	—	—	—	—	11,658	—	—	—	—	11,658	2,712
Net income (loss)	\$ 43,702	\$ (27,648)	\$ (28,021)	\$ (329)	\$ (10,149)	\$ (13,653)	\$ (5,842)	\$ —	\$ —	\$ (66)	\$ (85,708)	\$ (42,006)
Earnings (loss) per common share—												
Basic	\$ 1.23											\$ (1.18)
Diluted	\$ 1.17											\$ (1.18)
Weighted average number of shares—												
Basic	35,485,395											35,485,395
Diluted	37,261,058											35,485,395

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MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

Statement of Cash Flows

The following table presents the impact of the restatement adjustments on the Company's consolidated statement of cash flows for nine months ended September 30, 2013:

	Nine Months Ended September 30, 2013		
	As Previously Reported	Restatement Adjustments	As Restated
Cash flows from operating activities			
Net income (loss)	\$ 43,702	\$ (85,708)	\$ (42,006)
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation and amortization	25,629	(653)	24,976
Provision for severance benefits	15,661	121	15,782
Bad debt expenses	214	(261)	(47)
Amortization of debt issuance costs and original issue discount	744	—	744
Loss (gain) on foreign currency translation, net	1,644	(1,698)	(54)
Restructuring and impairment charges	618	—	618
Stock-based compensation	1,398	160	1,558
Loss on early extinguishment of senior notes	32,812	—	32,812
Other	1,280	—	1,280
Changes in operating assets and liabilities			
Accounts receivable	(59,311)	71,801	12,490
Inventories, net	8,398	(9,320)	(922)
Other receivables	(284)	(1,170)	(1,454)
Other current assets	8,168	112	8,280
Deferred tax assets	(10,038)	11,629	1,591
Accounts payable	(2,314)	(964)	(3,278)
Other accounts payable	(7,901)	1,729	(6,172)
Accrued expenses	1,004	3,795	4,799
Other current liabilities	(663)	(4,194)	(4,857)
Other non-current liabilities	(1,465)	9,407	7,942
Payment of severance benefits	(4,331)	—	(4,331)
Other	(349)	1	(348)
Net cash provided by operating activities	<u>54,616</u>	<u>(5,213)</u>	<u>49,403</u>
Cash flows from investing activities			
Purchase of plant, property and equipment	(45,703)	5,110	(40,593)
Payment for intellectual property registration	(401)	—	(401)
Payment of guarantee deposits	(941)	—	(941)
Other	345	—	345
Net cash used in investing activities	<u>(46,700)</u>	<u>5,110</u>	<u>(41,590)</u>
Cash flows from financing activities			
Proceeds from issuance of common stock	9,676	—	9,676
Proceeds from issuance of senior notes	218,836	—	218,836
Repayment of long-term borrowings	(229,333)	—	(229,333)
Acquisition of treasury stock	(31,000)	—	(31,000)
Net cash used in financing activities	<u>(31,821)</u>	<u>—</u>	<u>(31,821)</u>
Effect of exchange rates on cash and cash equivalents	(65)	103	38
Net decrease in cash and cash equivalents	<u>(23,970)</u>	<u>—</u>	<u>(23,970)</u>
Cash and cash equivalents			
Beginning of the period	182,238	—	182,238
End of the period	<u>\$ 158,268</u>	<u>\$ —</u>	<u>\$ 158,268</u>
Supplemental cash flow information			
Cash paid for interest	<u>\$ 16,266</u>	<u>\$ —</u>	<u>\$ 16,266</u>
Cash paid for income taxes	<u>\$ 6,397</u>	<u>\$ (180)</u>	<u>\$ 6,217</u>
Non-cash investing activities			
Property, plant and equipment additions in other accounts payable	<u>\$ —</u>	<u>\$ 57</u>	<u>\$ 57</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

Comprehensive Income

The following table presents the impact of the restatement adjustments on the Company's previously reported consolidated statements of comprehensive income for the three and nine months ended September 30, 2013:

	Three Months Ended September 30, 2013		Nine Months Ended September 30, 2013	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Net income (loss)	\$ 46,671	\$ 251	\$ 43,702	\$(42,006)
Other comprehensive income (loss)				
Foreign currency translation adjustments	(19,438)	(31,300)	(631)	(3,094)
Derivative adjustments				
Fair valuation of derivatives	12,392	16,102	3,122	4,281
Reclassification adjustment for loss (gain) on derivatives included in net income (loss)	74	(34)	(235)	(289)
Unrealized gain on investments	34	45	399	540
Total comprehensive income (loss)	<u>\$ 39,733</u>	<u>\$(14,936)</u>	<u>\$ 46,357</u>	<u>\$(40,568)</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

3. Sales of Accounts Receivable and Receivable Discount Program

The Company has entered into an agreement to sell selected trade accounts receivable to a financial institution from time to time since March 2012. After the sale, the Company does not retain any interest in the receivables and the applicable financial institution collects these accounts receivable directly from the customer. The proceeds from the sales of these accounts receivable totaled \$12,832 thousand and \$24,749 thousand for the nine months ended September 30, 2014 and 2013, respectively, and these sales resulted in pre-tax losses of \$39 thousand and \$59 thousand for the nine months ended September 30, 2014 and 2013, respectively, which are included in selling, general and administrative expenses in the consolidated statements of operations. Net proceeds of this accounts receivable sale program are recognized in the consolidated statements of cash flows as part of operating cash flows.

The Company uses receivable discount programs with certain customers. These discount arrangements allow the Company to accelerate collection of customers' receivables. While these arrangements have reduced the Company's working capital needs, there can be no assurance that these programs will continue in the future.

4. Inventories

Inventories as of September 30, 2014 and December 31, 2013 consist of the following:

	September 30, 2014	December 31, 2013
Finished goods	\$ 41,794	\$ 43,734
Semi-finished goods and work-in-process	80,842	92,030
Raw materials	8,183	9,464
Materials in-transit and other	1,023	1,870
Less: inventory reserve	(55,148)	(72,400)
Inventories, net	<u>\$ 76,694</u>	<u>\$ 74,698</u>

	Three Months Ended	Nine Months Ended	Three Months Ended	Nine Months Ended
	September 30, 2014		September 30, 2013 (As Restated)	
Beginning balance	\$ (65,670)	\$ (72,400)	\$ (36,912)	\$ (25,429)
Change in reserve	389	(3,033)	(17,484)	(31,784)
Write off	8,008	20,746	626	1,058
Translation adjustments	2,125	(461)	(3,171)	(786)
Ending balance	<u>\$ (55,148)</u>	<u>\$ (55,148)</u>	<u>\$ (56,941)</u>	<u>\$ (56,941)</u>

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

5. Property, Plant and Equipment

Property, plant and equipment as of September 30, 2014 and December 31, 2013 comprise the following:

	September 30, 2014	December 31, 2013
Buildings and related structures	\$ 81,981	\$ 81,050
Machinery and equipment	283,085	269,840
Vehicles and others	25,053	22,397
	390,119	373,287
Less: accumulated depreciation	(157,711)	(136,397)
Land	17,485	17,407
Property, plant and equipment, net	<u>\$ 249,893</u>	<u>\$ 254,297</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

6. Intangible Assets

Intangible assets as of September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014	December 31, 2013
Technology	\$ 20,170	\$ 20,081
Customer relationships	29,576	29,444
Intellectual property assets	8,575	7,829
Less: accumulated amortization	(55,733)	(54,243)
Intangible assets, net	\$ 2,588	\$ 3,111

7. Accrued Expenses

Accrued expenses as of September 30, 2014 and December 31, 2013 are as follows:

	September 30, 2014	December 31, 2013
Payroll, benefits and related taxes, excluding severance benefits	\$ 22,703	\$ 19,869
Withholding tax levied on intercompany interest income	26,509	23,872
Interest on senior notes	3,105	6,749
Settlement obligations	3,943	6,460
Outside service fees	10,215	1,462
Others	10,920	7,082
Accrued expenses	\$ 77,395	\$ 65,494

Settlement obligations

Settlement obligations related to settling claims involving the Company's products are accrued when they are deemed probable and can be reasonably estimated. As of September 30, 2014, the settlement obligation of \$4,303 thousand is included in other non-current liabilities in the consolidated balance sheet.

8. Derivative Financial Instruments

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

Details of derivative contracts as of September 30, 2014 are as follows:

<u>Date of transaction</u>	<u>Type of derivative</u>	<u>Total notional amount</u>	<u>Month of settlement</u>
May 29, 2013	Zero cost collar	\$ 54,000	October to December 2014

The forward and zero cost collar contracts qualify as cash flow hedges under ASC 815, "Derivatives and Hedging," ("ASC 815"), since at both the inception of the contracts and on an ongoing basis, the hedging relationship was and is expected to be highly effective in achieving offsetting cash flows attributable to the hedged risk during the term of the contracts. The Company is utilizing the "hypothetical derivative" method to measure the effectiveness by comparing the changes in value of the actual derivative versus the change in fair value of the "hypothetical derivative."

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MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

The fair values of the Company's outstanding zero cost collar contracts recorded as assets as of September 30, 2014 and December 31, 2013 are as follows:

<u>Derivatives designated as hedging instruments:</u>	September 30, 2014	December 31, 2013
Asset Derivatives:		
Zero cost collars	\$ 2,077	\$ 4,912

Offsetting of derivative assets as of September 30, 2014 and December 31, 2013 is as follows:

As of September 30, 2014	Gross amounts of recognized assets/liabilities	Gross amounts offset in the balance sheets	Net amounts of assets/liabilities presented in the balance sheets	Gross amounts not offset in the balance sheets		Net amount
Asset Derivatives:				Financial instruments	Cash collateral received/pledged	
Zero cost collars	\$ 2,077	\$ —	\$ 2,077	\$ —	\$ —	\$ 2,077

As of December 31, 2013	Gross amounts of recognized assets/liabilities	Gross amounts offset in the balance sheets	Net amounts of assets/liabilities presented in the balance sheets	Gross amounts not offset in the balance sheets		Net amount
Asset Derivatives:				Financial instruments	Cash collateral received/pledged	
Zero cost collars	\$ 4,912	\$ —	\$ 4,912	\$ —	\$ —	\$ 4,912

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

The following table summarizes the impact of derivative instruments on the consolidated statements of operations for the three months ended September 30, 2014 and 2013:

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) Three Months Ended Sep. 30, 2013		Location of Gain (Loss) Reclassified from AOCI into Statement of Operations (Effective Portion)	Amount of Gain (Loss) Reclassified from AOCI into Statement of Operations (Effective Portion) Three Months Ended Sep. 30, 2013		Location of Gain (Loss) Recognized in Statement of Operations on Derivative (Ineffective Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain (Loss) Recognized in Statement of Operations on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing) Three Months Ended Sep. 30, 2013	
	2014	(As Restated)		2014	(As Restated)		2014	(As Restated)
Forward	\$ —	\$ 3,252	Net sales	\$ —	\$ 780	Other income (expenses) — Others	\$ —	\$ 280
Zero cost collars	(3,319)	12,850	Net sales	3,048	(746)	Other income (expenses) — Others	(9)	375
Total	<u>\$(3,319)</u>	<u>\$ 16,102</u>		<u>\$3,048</u>	<u>\$ 34</u>		<u>\$ (9)</u>	<u>\$ 655</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

The following table summarizes the impact of derivative instruments on the consolidated statements of operations for the nine months ended September 30, 2014 and 2013:

Derivatives in ASC 815 Cash Flow Hedging Relationships	Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion)		Location of Gain (Loss) Reclassified from AOCI into Statement of Operations (Effective Portion)	Amount of Gain (Loss) Reclassified from AOCI into Statement of Operations (Effective Portion)		Location of Gain (Loss) Recognized in Statement of Operations on Derivative Portion and Amount Excluded from Effectiveness Testing)	Amount of Gain (Loss) Recognized in Statement of Operations on Derivatives (Ineffective Portion and Amount Excluded from Effectiveness Testing)	
	Nine Months Ended Sep. 30,			Nine Months Ended Sep. 30,			Nine Months Ended Sep. 30,	
	2013 (As Restated)			2013 (As Restated)			2013 (As Restated)	
	2014	(As Restated)		2014	(As Restated)		2014	(As Restated)
Forward	\$ —	\$ 2,972	Net sales	\$ —	\$ 780	Other income (expenses) — Others	\$—	\$ 173
Zero cost collars	<u>2,882</u>	<u>1,309</u>	Net sales	<u>5,692</u>	<u>(491)</u>	Other income (expenses) — Others	<u>(61)</u>	<u>37</u>
Total	<u>\$2,882</u>	<u>\$ 4,281</u>		<u>\$5,692</u>	<u>\$ 289</u>		<u>\$(61)</u>	<u>\$ 210</u>

As of September 30, 2014, the amount expected to be reclassified from accumulated other comprehensive income into earnings within the next twelve months is \$2,029 thousand.

The Company's forward and zero cost collar contracts are subject to termination upon the occurrence of the following events:

(i) On the last day of a fiscal quarter, the sum of qualified and unrestricted cash and cash equivalents held by the Company is less than \$30 million.

(ii) The rating of the Company's debt is B- or lower by Standard & Poor's Ratings Group or any successor rating agency thereof ("S&P") or B3 or lower by Moody's Investor Services, Inc. or any successor rating agency thereof ("Moody's") or the Company's debt ceases to be assigned a rating by either S&P or Moody's.

On September 1, 2014, the Company and the counterparty, the Goldman Sachs International bank ("GS"), mutually agreed to terminate a zero cost collar contract under termination provisions of the International Swaps and Derivatives Association ("ISDA") agreement. In connection with this termination, the Company received \$1,050 thousand for settlement proceeds from GS.

On September 30, 2014, the Company and the counterparty, the UBS AG, Seoul Branch ("UBS"), mutually agreed to terminate a zero cost collar contract under termination provisions of the ISDA agreement. In connection with this termination, the Company received \$430 thousand for settlement proceeds from UBS.

In addition, the Company is required to deposit cash collateral with a financial institution, the counterparty to the zero cost collar contract, for any exposure in excess of \$5 million. No cash collateral was required as of September 30, 2014.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

9. Fair Value Measurements

The Company's financial assets and liabilities measured at fair value on a recurring basis as of September 30, 2014, and the basis for that measurement is as follows:

	<u>Carrying Value</u>	<u>Fair Value Measurement</u>	<u>Quoted Prices in Active Markets for Identical Asset (Level 1)</u>	<u>Significant Other Observable Inputs (Level 2)</u>	<u>Significant Unobservable Inputs (Level 3)</u>
Assets:					
Derivative assets (other current assets)	\$ 2,077	\$ 2,077	\$ —	\$ 2,077	\$ —

As of September 30, 2014, the total carrying value and estimated fair value of the Company's 6.625% Senior Notes due 2021 (the "2021 Notes"), which are not measured at fair value on a recurring basis, were \$224,007 thousand and \$212,850 thousand, respectively. The estimated fair value is based on Level 2 inputs.

10. Long-Term Borrowings

Long-term borrowings as of September 30, 2014 and December 31, 2013 are as follows:

	<u>September 30, 2014</u>	<u>December 31, 2013</u>
6.625% senior notes due July 2021	\$ 225,000	\$ 225,000
Discount on senior notes	(993)	(1,077)
Long-term borrowings, net of unamortized discount	<u>\$ 224,007</u>	<u>\$ 223,923</u>

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

The Company used net proceeds from the issuance of the 2021 Notes of \$218.8 million, which represents \$225.0 million of principal amount net of \$1.1 million of original issue discount and \$5.1 million of debt issuance costs, together with cash on hand, to repay all of the Company's 10.500% senior notes due April 2018, including applicable premium and accrued interest, and to pay related fees and expenses of the 2021 Notes offering.

In connection with the refinancing of the Company's senior notes, the Company recognized \$32.8 million of loss on early extinguishment of senior notes, which consisted of \$23.8 million from the applicable premium, \$5.3 million from write-off of debt issuance costs, \$1.9 million from write-off of discounts and \$1.8 million of interest incurred during the notice period.

The Company can optionally redeem all or a part of the 2021 Notes according to the following schedule: (i) at any time prior to July 15, 2016, the Company may on any one or more occasions redeem up to 35% of the aggregate principal amount of 2021 Notes issued under the Indenture, dated as of July 18, 2013, as supplemented by that certain First Supplemental Indenture, dated as of March 27, 2014 (collectively, the "Indenture") at a redemption price equal to 106.625% of the principal amount of the 2021 Notes redeemed, plus accrued and unpaid interest and special interest, if any, to the date of redemption with the net proceeds of a qualified equity offering; (ii) at any time prior to July 15, 2017, the Company may on any one or more occasions redeem all or a part of the 2021 Notes at a redemption price equal to 100% of the principal amount of the notes redeemed, plus the applicable premium as of, and accrued and unpaid interest and special interest, if any, to the date of redemption; and (iii) on or after July 15, 2017, the Company may on any one or more occasions redeem all or a part of the 2021 Notes, at a redemption price equal to 103.313%, 101.656% and 100% of the principal amount of the notes redeemed in 2017, 2018 and 2019 and thereafter, respectively, plus accrued and unpaid interest and special interest, if any, on the notes redeemed, to the applicable date of redemption.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

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

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

As disclosed in the Company's Form 8-K filed on June 25, 2014, the Company received a notice of default on June 20, 2014 (the "10-K and Q1 10-Q Notice of Default") from Wilmington Trust, National Association, as trustee, under the Indenture related to the 2021 Notes. The 10-K and Q1 10-Q Notice of Default related to the failure by the Company, pursuant to Section 4.03 of the Indenture, to file with the SEC its Annual Report on Form 10-K for the fiscal year ended December 31, 2013 and its Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2014 (the "Initial Reporting Defaults"). The Company did not cure the Initial Reporting Defaults within the applicable 60-day grace period and the Initial Reporting Defaults ripened into Events of Default. The Company elected, as the sole and exclusive remedy for the Events of Default, to pay additional interest on the 2021 Notes at a rate equal to 0.25% per annum of the principal amount of the 2021 Notes (the "Additional Interest") for a period of 180 days following the occurrence of the Events of Default (the "Additional Interest Period").

On August 20, 2014, the Company received a notice of default related to its failure to file its Form 10-Q for the fiscal quarter ended June 30, 2014 (the "Q2 10-Q Notice of Default"), and on November 19, 2014, the Company received a notice of default related to its failure to file its Form 10-Q for the fiscal quarter ended September 30, 2014 (the "Q3 10-Q Notice of Default"). These defaults also ripened into Events of Default and on December 29, 2014 and January 15, 2015, respectively, the Company elected to extend the Additional Interest Period for up to 180 days following each additional Event of Default.

Upon the filing with the SEC of the 2013 Form 10-K, the Form 10-Qs for each of the fiscal quarters ended March 31, 2014 and June 30, 2014, and this Report, the Company believes it has regained compliance with its reporting obligations under the Indenture and cured all identified covenant defaults in each of the 10-K and Q1 10-Q Notice of Default, the Q2 10-Q Notice of Default, and the Q3 10-Q Notice of Default, and has ceased accruing the Additional Interest on the 2021 Notes as of the filing date of this Report.

In connection with the issuance of the 2021 Notes, the Company capitalized certain costs and fees, which are being amortized using the effective interest method over its respective term, 2013 to 2021. Amortization costs, which were included in interest expense in the accompanying statements of operations, amounted to \$128 thousand and \$375 thousand for the three and nine months ended September 30, 2014, respectively. The remaining capitalized costs as of September 30, 2014, which were included in other non-current assets in the consolidated balance sheet, were \$4,449 thousand.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

11. Accrued Severance Benefits

The majority of accrued severance benefits is for employees in the Company’s Korean subsidiary, MagnaChip Semiconductor Ltd. Pursuant to the Employee Retirement Benefit Security Act of Korea, eligible employees and executive officers with one or more years of service are entitled to severance benefits upon the termination of their employment based on their length of service and rate of pay. As of September 30, 2014, 98% of employees of the Company were eligible for severance benefits.

Changes in accrued severance benefits are as follows:

	Three Months Ended	Nine Months Ended	Three Months Ended	Nine Months Ended
	September 30, 2014		September 30, 2013 (As Restated)	
Beginning balance	\$146,923	\$135,356	\$115,610	\$116,036
Provisions	5,349	14,775	5,014	15,782
Severance payments	(1,222)	(4,712)	(1,392)	(4,331)
Translation adjustments	(5,144)	487	8,066	(189)
	<u>145,906</u>	<u>145,906</u>	<u>127,298</u>	<u>127,298</u>
Less: Cumulative contributions to the National Pension Fund	(372)	(372)	(380)	(380)
Group severance insurance plan	(795)	(795)	(773)	(773)
Accrued severance benefits, net	<u>\$144,739</u>	<u>\$144,739</u>	<u>\$126,145</u>	<u>\$126,145</u>

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

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

	Severance benefits
Remainder of 2014	\$ 381
2015	303
2016	1,210
2017	1,783
2018	3,049
2019	2,360
2020 – 2024	24,782

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

12. Foreign Currency Gain (Loss), Net

Net foreign currency gain or loss includes non-cash translation gain or loss associated with intercompany balances. A substantial portion of the Company’s net foreign currency gain or loss is non-cash translation gain or loss associated with intercompany long-term loans to our Korean subsidiary. The loans are denominated in U.S. dollars and are affected by changes in the exchange rate between the Korean won and the U.S. dollar. As of September 30, 2014, the total intercompany loan balance was \$510 million. The Korean won to U.S. dollar exchange rates were 1,050.6:1 and 1,055.3:1 using the first base rate as of September 30, 2014 and December 31, 2013, respectively, as quoted by the Korea Exchange Bank.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

13. Income Taxes

The Company files income tax returns in the U.S., Korea, Japan, Taiwan and various other jurisdictions.

The Company's Korean subsidiary, MagnaChip Semiconductor, Ltd., is the principal operating entity within the consolidated Company. For the three and nine months ended September 30, 2014 and 2013, no income tax expense for MagnaChip Semiconductor, Ltd. was recorded due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets.

Income tax expense recorded for the three months ended September 30, 2014 and 2013 was \$311 thousand and \$475 thousand (restated), respectively, and for the nine months ended September 30, 2014 and 2013 was \$1,770 thousand and \$2,712 thousand (restated), respectively, primarily attributable to withholding taxes related to intercompany balances and net operating loss carry-back at the parent company and a domestic subsidiary.

14. Geographic and Segment Information

The Company has one operating segment, consisting of three business lines: Display Solutions, Power Solutions and Semiconductor Manufacturing Services. The Company's chief operating decision maker is considered to be its Chief Executive Officer. The chief operating decision maker allocates resources and assesses performance of the business and other activities at the operating segment level.

The following is a summary of net sales by business line:

	Three Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Net Sales		
Display Solutions	\$ 58,700	\$ 44,095
Semiconductor Manufacturing Services	99,333	90,263
Power Solutions	36,088	36,366
All other	211	88
Total net sales	<u>\$ 194,332</u>	<u>\$ 170,812</u>

	Nine Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Net Sales		
Display Solutions	\$ 144,406	\$ 160,091
Semiconductor Manufacturing Services	281,600	304,678
Power Solutions	104,138	93,561
All other	422	337
Total net sales	<u>\$ 530,566</u>	<u>\$ 558,667</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

The following is a summary of net sales by region, based on the location of the customer:

	Three Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Korea	\$ 84,763	\$ 74,060
Asia Pacific (other than Korea)	80,123	68,496
U.S.A.	25,079	22,786
Europe	3,829	4,504
Others	538	966
Total	<u>\$ 194,332</u>	<u>\$ 170,812</u>

	Nine Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Korea	\$ 219,096	\$ 239,081
Asia Pacific (other than Korea)	224,681	209,219
U.S.A.	69,428	78,536
Europe	16,323	29,100
Others	1,038	2,731
Total	<u>\$ 530,566</u>	<u>\$ 558,667</u>

Net sales from the Company's top ten largest customers accounted for 66% and 53% for the three months ended September 30, 2014 and 2013, respectively, and 60% and 61% for the nine months ended September 30, 2014 and 2013, respectively.

For the three months ended September 30, 2014, we had three customers which represented 13.9%, 10.7% and 10.2% of the Company's net sales, respectively, and for the nine months ended September 30, 2014, we had one customer which represented 11.2% of the Company's net sales.

For the three months ended September 30, 2013, we had one customer which represented 10.2% of the Company's net sales, and for the nine months ended September 30, 2013, we had two customers which represented 12.0% and 10.2% of the Company's net sales.

Over 99% of the Company's property, plant and equipment are located in Korea as of September 30, 2014.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

15. Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss consists of the following as of September 30, 2014 and December 31, 2013, respectively:

	September 30, 2014	December 31, 2013
Foreign currency translation adjustments	\$ (59,788)	\$ (57,326)
Derivative adjustments	3,777	6,587
Unrealized gain on investments	—	681
Total	<u>\$ (56,011)</u>	<u>\$ (50,058)</u>

Changes in accumulated other comprehensive loss for the three months ended September 30, 2014 and 2013 is as follows:

	Foreign currency translation adjustments	Derivative adjustments	Unrealized gain on investments	Total
Three Months Ended September 30, 2014				
Beginning balance	\$ (76,662)	\$ 10,144	\$ —	\$(66,518)
Other comprehensive income (loss) before reclassifications	16,874	(3,319)	—	13,555
Amounts reclassified from accumulated other comprehensive income	—	(3,048)	—	(3,048)
Net current-period other comprehensive income (loss)	16,874	(6,367)	—	10,507
Ending balance	<u>\$ (59,788)</u>	<u>\$ 3,777</u>	<u>\$ —</u>	<u>\$(56,011)</u>
Three Months Ended September 30, 2013 (As Restated)				
Beginning balance	\$ (15,393)	\$ (10,002)	\$ 570	\$(24,825)
Other comprehensive income (loss) before reclassifications	(31,300)	16,102	45	(15,153)
Amounts reclassified from accumulated other comprehensive income	—	(34)	—	(34)
Net current-period other comprehensive income (loss)	(31,300)	16,068	45	(15,187)
Ending balance	<u>\$ (46,693)</u>	<u>\$ 6,066</u>	<u>\$ 615</u>	<u>\$(40,012)</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

Changes in accumulated other comprehensive loss for the nine months ended September 30, 2014 and 2013 is as follows:

	Foreign currency translation adjustments	Derivative adjustments	Unrealized gain on investments	Total
Nine Months Ended September 30, 2014				
Beginning balance	\$ (57,326)	\$ 6,587	\$ 681	\$(50,058)
Other comprehensive income (loss) before reclassifications	(2,462)	2,882	1,201	1,621
Amounts reclassified from accumulated other comprehensive income	—	(5,692)	(1,882)	(7,574)
Net current-period other comprehensive loss	(2,462)	(2,810)	(681)	(5,953)
Ending balance	<u>\$ (59,788)</u>	<u>\$ 3,777</u>	<u>\$ —</u>	<u>\$(56,011)</u>
	Foreign currency translation adjustments	Derivative adjustments	Unrealized gain on investments	Total
Nine Months Ended September 30, 2013 (As Restated)				
Beginning balance	\$ (43,599)	\$ 2,074	\$ 75	\$(41,450)
Other comprehensive income (loss) before reclassifications	(3,094)	4,281	540	1,727
Amounts reclassified from accumulated other comprehensive income	—	(289)	—	(289)
Net current-period other comprehensive income (loss)	(3,094)	3,992	540	1,438
Ending balance	<u>\$ (46,693)</u>	<u>\$ 6,066</u>	<u>\$ 615</u>	<u>\$(40,012)</u>

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

16. Earnings (loss) per Share

The following table illustrates the computation of basic and diluted loss per common share:

	Three Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Net income (loss)	\$ (46,807)	\$ 251
Weighted average common stock outstanding		
Basic	34,056,359	35,443,820
Diluted	34,056,359	37,484,601
Earnings (loss) per share		
Basic	\$ (1.37)	\$ 0.01
Diluted	\$ (1.37)	\$ 0.01

	Nine Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)
Net loss	\$ (53,402)	\$ (42,006)
Weighted average common stock outstanding		
Basic	34,055,210	35,485,395
Diluted	34,055,210	35,485,395
Loss per share		
Basic	\$ (1.57)	\$ (1.18)
Diluted	\$ (1.57)	\$ (1.18)

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

	Three Months Ended		Nine Months Ended	
	September 30, 2014	September 30, 2013 (As Restated)	September 30, 2014	September 30, 2013 (As Restated)
Options	3,178,645	10,000	3,178,645	2,881,375
Warrants	1,425,129	—	1,425,129	1,517,930

17. Commitments and Contingencies

Matters Related to the Audit Committee’s Investigation, the Restatement of Certain of the Company’s Consolidated Financial Statements, the State of the Company’s Internal Control Over Financial Reporting and the Company’s Failure to Timely File Periodic Reports with the SEC

Securities Class Action Complaint

On March 12, 2014, a purported class action was filed against the Company and certain of the Company’s current and now-former officers on behalf of shareholders who purchased or acquired the Company’s securities between February 1, 2012 and March 11, 2014. On September 30, 2014, an amended complaint was filed against the Company, certain current and now-former officers of the Company, certain members of the Company’s Board of Directors, and a shareholder of the Company, alleging violations of Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder. The action, *Thomas et al., v. MagnaChip Semiconductor Corp., et al.*, No. 3:14-CV-1160, is pending in the Northern District of California. The Court has granted the plaintiffs thirty days from the date the 2013 Form 10-K is filed with the SEC to file and serve a further amended complaint. At this time, the Company is unable to estimate any reasonably possible loss, or range of reasonably possible losses, with respect to the matters described above.

MagnaChip Semiconductor Corporation and Subsidiaries
Notes to Consolidated Financial Statements – (Continued)
(Unaudited; tabular dollars in thousands, except share data)

SEC Enforcement Staff Investigation

In addition, in March 2014, the Company voluntarily reported to the SEC that the Audit Committee had determined that the Company incorrectly recognized revenue on certain transactions and as a result would restate its financial statements, and that the Audit Committee had commenced the Independent Investigation. Over the course of 2014, the Company voluntarily produced documents to the SEC regarding the various accounting issues identified during the Independent Investigation, and whether the Company's hiring of an accountant from the Company's independent registered public accounting firm impacted that accounting firm's independence. On July 22, 2014, the Staff of the SEC's Division of Enforcement obtained a Formal Order of Investigation. The Company will continue to cooperate with the SEC in this investigation. At this time, the Company is unable to estimate any reasonably possible loss, or range of reasonably possible losses, with respect to the matters described above.

18. Subsequent Events

Late Filings

On November 12, 2014, we filed a Notification of Late Filing on Form 12b-25 with the SEC disclosing that we would be unable to timely file our Quarterly Report on Form 10-Q for the quarter ended September 30, 2014 with the SEC.

Restatement

On February 12, 2015, the Company filed with the SEC its 2013 Form 10-K containing audited financial statements of the Company for the year ended December 31, 2013 and audited restated financial statements for the years ended December 31, 2012 and 2011.

NYSE Actions

On April 4, 2014, we filed a Current Report on Form 8-K with the SEC announcing that on April 2, 2014 we received from NYSE Regulation, Inc. (the "NYSE") a notice of failure to satisfy a continued listing rule or standard and related monitoring. The notice informed us that, as a result of our failure to timely file our 2013 Form 10-K, we are subject to the procedures specified in Section 802.01E (SEC Annual Report Timely Filing Criteria) of the NYSE Listed Company Manual ("Section 802.01E"). Under the Section 802.01E procedures, the NYSE will monitor the status of the filing of the 2013 Form 10-K and related public disclosures for up to a six-month period from its due date. If the Company did not file the 2013 Form 10-K within six months from the filing due date, the NYSE may, in its sole discretion, allow the Company's common stock to trade for up to an additional six months pending the filing of the 2013 Form 10-K prior to commencing suspension or delisting procedures, depending on the Company's specific circumstances.

On September 5, 2014, we made a request to the NYSE that our shares be permitted to continue to trade on the NYSE while the Company completed its restatement of the consolidated financial statements. On October 3, 2014, we received an extension for continued listing and trading of the Company's common stock on the NYSE. The extension, was subject to ongoing reassessment by the NYSE, provided the Company with an additional trading period until April 1, 2015, during which the Company can file its 2013 Form 10-K with the SEC. On February 12, 2015, the Company filed its 2013 Form 10-K, and simultaneously filed its Form 10-Q for each of the quarters ended March 31, 2014, June 30, 2014 and September 30, 2014. The Company believes that these filings with the SEC satisfy the NYSE continued listing requirements.

Close of a fabrication facility

On December 4, 2014, the Company approved a plan to close its six-inch fabrication facility in Cheongju, South Korea (the "six-inch fab"). This plan is expected to be substantially implemented over the next 12 months, and the six-inch fab is expected to be closed by the end of 2015. The Company plans to transfer the six-inch fab employees to the Company's other facilities.

FORWARD LOOKING STATEMENTS

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

These forward-looking statements are largely based on our expectations and beliefs concerning future events, which reflect estimates and assumptions made by our management. These estimates and assumptions reflect our best judgment based on currently known market conditions and other factors relating to our operations and business environment, all of which are difficult to predict and many of which are beyond our control. Although we believe our estimates and assumptions to be reasonable, they are inherently uncertain and involve a number of risks and uncertainties that are beyond our control. In addition, management’s assumptions about future events may prove to be inaccurate. Management cautions all readers that the forward-looking statements contained in this report are not guarantees of future performance, and we cannot assure any reader that those statements will be realized or the forward-looking events and circumstances will occur. Actual results may differ materially from those anticipated or implied in the forward-looking statements due to the factors listed in this section and in “Part I: Item 1A. Risk Factors” in our annual report on Form 10-K for the fiscal year ended December 31, 2013.

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

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

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

The following discussion and analysis should be read in conjunction with the unaudited consolidated financial statements and the related notes included elsewhere in this report. This discussion and analysis contains, in addition to historical information, forward-looking statements that include risks and uncertainties. Our actual results may differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under the heading “Risk Factors” and elsewhere in this report.

Overview

We are a Korea-based designer and manufacturer of analog and mixed-signal semiconductor products for high-volume consumer, computer and communication applications. We believe we have one of the broadest and deepest analog and mixed-signal semiconductor technology platforms in the industry, supported by our 30-year operating history, large portfolio of approximately 3,062 registered novel patents and 134 pending novel patent applications and extensive engineering and manufacturing process expertise. Our business is comprised of three key business lines: Display Solutions, Power Solutions and Semiconductor Manufacturing Services. Our Display Solutions products include display drivers that cover a wide range of flat panel displays and multimedia devices. Our Power Solutions products include discrete and integrated circuit solutions for power management in high-volume consumer, computer, communication and industrial applications. Our Semiconductor Manufacturing Services provide specialty analog and mixed-signal foundry services for fabless semiconductor companies that serve the consumer, computing and wireless end markets.

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

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

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

Demand for our products and services is driven primarily by overall demand for consumer electronics products and can be adversely affected by periods of weak consumer spending or by market share losses by our customers. To mitigate the impact of market volatility on our business, we seek to address markets and geographies with higher growth rates than the overall consumer electronics industry. We also expect that new competitors will emerge in these markets that may place increased pressure on the pricing for our products and services. While we believe we are well positioned competitively to compete in these markets and against these new competitors as a result of our long operating history, existing manufacturing capacity and our Korea-based operations, if we are not effective in competing in these markets our operating results may be adversely affected.

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

Within the Semiconductor Manufacturing Services business, net sales are driven by customers’ decisions on which manufacturing services provider to use for a particular product. Most of our Semiconductor Manufacturing Services customers are fabless and depend upon service providers like us to manufacture their products. A customer will often have more than one supplier of manufacturing services; however, they tend to allocate a majority of manufacturing volume to one of their suppliers. We strive to be the primary supplier of manufacturing services to our customers. Once selected as a primary supplier, we often specify the pricing of a

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particular service on a per wafer basis for a set period of time, with periodic discussions and renegotiations of pricing with our customers. In any given period, our net sales depend heavily upon the end-market demand for the goods in which the products we manufacture for customers are used, the inventory levels maintained by our customers and in some cases, allocation of demand for manufacturing services among selected qualified suppliers.

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

Our products and services require investments in capital equipment. Analog and mixed-signal manufacturing facilities and processes are typically distinguished by the design and process implementation expertise rather than the use of the most advanced equipment. These processes also tend to migrate more slowly to smaller geometries due to technological barriers and increased costs. For example, some of our products use high-voltage technology that requires larger geometries and that may not migrate to smaller geometries for several years, if at all. Additionally, the performance of many of our products is not necessarily dependent on geometry. As a result, our manufacturing base and strategy do not require substantial investment in leading edge process equipment, allowing us to utilize our facilities and equipment over an extended period of time with moderate required capital investments. Generally, incremental capacity expansions in our business line of the market result in more moderate industry capacity expansion as compared to leading edge processes. As a result, this market, and we, specifically, are less likely to experience significant industry overcapacity, which can cause product prices to decline significantly. In general, we seek to invest in manufacturing capacity that can be used for multiple high-value applications over an extended period of time. We believe this capital investment strategy enables us to optimize our capital investments and facilitates deeper and more diversified product and service offerings.

Our success going forward will depend upon our ability to adapt to future challenges such as the emergence of new competitors for our products and services or the consolidation of current competitors. Additionally, we must innovate to remain ahead of, or at least rapidly adapt to, technological breakthroughs that may lead to a significant change in the technology necessary to deliver our products and services. We believe that our established relationships and close collaboration with leading customers enhance our visibility into new product opportunities, market and technology trends and improve our ability to meet these challenges successfully. In our Semiconductor Manufacturing Services business, we strive to maintain competitiveness and our position as a primary manufacturing services provider to our customers by offering high-value added processes, high-flexibility and excellent service.

Other Significant Events

In March 2011, we completed our initial public offering of 9,500,000 shares of common stock, which we listed on the NYSE. All shares were sold in the form of depositary shares and each depositary share represented an ownership interest in one share of common stock. Of the 9,500,000 shares, 950,000 shares were newly issued by us and 8,550,000 shares were sold by selling stockholders. All outstanding depositary shares were automatically cancelled on April 24, 2011 and the underlying shares of common stock were issued to the holders of such cancelled depositary shares. We received \$12.4 million of proceeds from the issuance of the new shares of common stock after deducting underwriters' discounts and commissions, and we did not receive any proceeds from the sale of shares of common stock offered by the selling stockholders. We incurred \$10.8 million of expenses in our initial public offering that were recorded as decrease of additional paid-in capital in our consolidated balance sheets.

Prior to our initial public offering, MagnaChip Semiconductor LLC, a Delaware limited liability company, was converted to MagnaChip Semiconductor Corporation, a Delaware corporation. In connection with the corporate conversion, outstanding common units of MagnaChip Semiconductor LLC were automatically converted into shares of common stock of MagnaChip Semiconductor Corporation, outstanding options to purchase common units of MagnaChip Semiconductor LLC were automatically converted into options to purchase shares of common stock of MagnaChip Semiconductor Corporation and outstanding warrants to purchase common units of MagnaChip Semiconductor LLC were automatically converted into warrants to purchase shares of common stock of MagnaChip Semiconductor Corporation, all at a ratio of one share of common stock for eight common units.

On May 16, 2011, two of our wholly owned subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, repurchased \$35.0 million out of \$250.0 million aggregate principal amount of our senior notes then outstanding at a price of 109.0% from funds affiliated with Avenue Capital Management II, L.P., one of our stockholders. In connection with the May 2011 repurchase of the senior notes, the Company recognized \$4.1 million of loss on early extinguishment of senior notes, which consisted of \$3.2 million from repurchase premium, \$0.4 million from write-off of discounts, \$0.2 million from write-off of debt issuance costs and \$0.3 million from incurrence of direct legal and advisory service fees.

On September 19, 2011, two of our wholly owned subsidiaries, MagnaChip Semiconductor S.A. and MagnaChip Semiconductor Finance Company, repurchased \$11.3 million out of \$215 million aggregate principal amount of our senior notes then

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outstanding at a price of 107.5%. In connection with the September 2011 repurchase of the senior notes, we recognized \$1.4 million of loss on early extinguishment of senior notes, which consisted of \$0.9 million from repurchase premium, \$0.1 million from write-off of discounts, \$0.4 million from write-off of debt issuance costs.

On October 7, 2011, our Board adopted a stock repurchase program whereby we may, subject to prevailing market conditions and other factors, repurchase up to \$35.0 million of our outstanding common stock. Our Board extended and increased the program by an additional \$25.0 million in August 2012, for a maximum aggregate repurchase amount under the original program of up to \$60.0 million. On July 30, 2013, we announced that the Board approved a new stock repurchase program under which we are authorized to repurchase up to \$100.0 million of our common stock. The new stock repurchase program was effective August 5, 2013 through December 15, 2014, and replaced the original stock repurchase program. The stock repurchase program did not require that we purchase a minimum amount of shares of our common stock and may be commenced, suspended, resumed or terminated at any time without notice. The timing and extent of any repurchases were dependent upon prevailing market conditions, the trading price of the Company's common stock and other factors, and subject to contractual restrictions and restrictions under applicable law and regulations. As of December 31, 2013, we had repurchased 6,578,765 shares of our common stock in the open market under these programs at an aggregate cost of \$90.9 million. In March 2014, the Board suspended the stock repurchase program indefinitely pending the completion of the Independent Investigation, and the stock repurchase program expired by its terms on December 15, 2014. Subsequent to December 31, 2013, we did not repurchase any shares under the stock repurchase program.

On May 1, 2012, we closed an underwritten registered public offering of 7,000,000 shares of our common stock owned by certain of our stockholders at a price per share of \$11.40. We did not receive any proceeds from the sale of our common stock by the selling stockholders but paid certain expenses in connection with such secondary offering.

On February 8, 2013, we closed an underwritten registered public offering of 5,750,000 shares of our common stock owned by certain of our stockholders at a price per share of \$14.50. We did not receive any proceeds from the sale of our common stock by the selling stockholders but paid certain expenses in connection with such secondary offering.

On July 18, 2013, we issued the 2021 Notes, at a price of 99.5%. Interest on the 2021 Notes accrues at a rate of 6.625% per annum, payable semi-annually on January 15 and July 15 of each year, beginning on January 15, 2014. We used net proceeds of the 2021 Notes, together with cash on hand, to repay all of our then outstanding 10.500% senior notes due April 15, 2018 (the "2018 Notes"), including applicable premium and accrued interest, and to pay related fees and expenses of the 2021 Notes offering.

On September 13, 2013, we closed an underwritten registered public offering of 1,700,000 shares of our common stock owned by certain of our stockholders at a price per share of \$21.20. We did not receive any proceeds from the sale of our common stock by the selling stockholders but paid certain expenses in connection with such secondary offering.

Business Lines

We operate three separate business lines within one segment: Display Solutions, Power Solutions and Semiconductor Manufacturing Services.

- **Display Solutions:** Our Display Solutions products include source and gate drivers and timing controllers that cover a wide range of flat panel displays used in LCD, light emitting diode (LED), 3D and OLED televisions, notebooks, mobile communications and entertainment devices. Our Display Solutions support the industry's most advanced display technologies, such as AMOLEDs, and LTPS, as well as high-volume display technologies such as TFTs. Our Display Solutions business represented 27.2% and 28.7% of our net sales for the nine months ended September 30, 2014 and September 30, 2013, respectively.
- **Power Solutions:** Our Power Solutions line produces power management semiconductor products including discrete and integrated circuit solutions for power management in high-volume consumer applications. These products include MOSFETs, insulated-gate bipolar transistors (IGBTs), power modules, AC-DC converters, DC-DC converters, LED drivers, switching regulators and linear regulators for a range of devices, including televisions, smartphones, mobile phones, desktop PCs, notebooks, tablet PCs, other consumer electronics, and industrial applications such as power suppliers, LED lighting, motor control and home appliances. Our Power Solutions business represented 19.6% and 16.7% of our net sales for the nine months ended September 30, 2014 and September 30, 2013, respectively.
- **Semiconductor Manufacturing Services:** Our Semiconductor Manufacturing Services line provides specialty analog and mixed-signal foundry services to fabless semiconductor companies that serve the consumer, computing and wireless end markets. We manufacture wafers based on our customers' product designs. We do not market these products directly to end customers but rather supply manufactured wafers and products to our customers to market to their end customers. We offer approximately 442 process flows to our manufacturing services customers. We also often partner with key customers to jointly develop or customize specialized processes that enable our customers to improve their products and allow us to develop unique manufacturing expertise. Our manufacturing services are targeted at customers who require differentiated,

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specialty analog and mixed-signal process technologies such as high voltage CMOS, embedded memory and power. These customers typically serve high-growth and high-volume applications in the consumer, computing and wireless end markets. Our Semiconductor Manufacturing Services business represented 53.1% and 54.5% of our net sales for the nine months ended September 30, 2014 and September 30, 2013, respectively.

Explanation and Reconciliation of Non-US GAAP Measures

Adjusted EBITDA and Adjusted Net Income

We use the terms Adjusted EBITDA and Adjusted Net Income throughout this Report. Adjusted EBITDA, as we define it, is a non-US GAAP measure. We define Adjusted EBITDA for the periods indicated as net income (loss), adjusted to exclude (i) depreciation and amortization, (ii) interest expense, net, (iii) income tax expenses (benefits), (iv) restructuring and impairment charges, (v) equity-based compensation expense, (vi) foreign currency loss (gain), net, (vii) derivative valuation loss (gain), net, (viii) secondary offering and others, (ix) loss on early extinguishment of senior notes and (x) restatement related expenses.

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

- Adjusted EBITDA eliminates the impact of a number of items that may be either one time or recurring items that we do not consider to be indicative of our core ongoing operating performance;
- we believe that Adjusted EBITDA is an enterprise level performance measure commonly reported and widely used by analysts and investors in our industry;
- our investor and analyst presentations will include Adjusted EBITDA; and
- we believe that Adjusted EBITDA provides investors with a more consistent measurement of period to period performance of our core operations, as well as a comparison of our operating performance to that of other companies in our industry.

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

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

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

	<u>Three Months Ended September 30, 2014</u>	<u>Nine Months Ended September 30, 2014</u>	<u>Three Months Ended September 30, 2013 As Restated</u>	<u>Nine Months Ended September 30, 2013 As Restated</u>
	(In millions)			
Net income (loss)	\$ (46.8)	\$ (53.4)	\$ 0.3	\$ (42.0)
Adjustments:				
Depreciation and amortization	7.8	22.9	8.4	25.0
Interest expense, net	4.1	12.2	4.5	16.3
Income tax expenses	0.3	1.8	0.5	2.7
Restructuring and impairment charges(a)	—	—	—	2.4
Equity-based compensation expense(b)	0.6	1.7	0.5	1.6
Foreign currency loss (gain), net(c)	23.5	(5.5)	(47.1)	(1.5)
Derivative valuation loss (gain), net(d)	—	0.1	(0.7)	(0.2)
Secondary offering and others(e)	—	—	0.5	1.4
Loss on early extinguishment of senior notes(f)	—	—	32.8	32.8
Restatement related expenses(g)	15.5	28.8	—	—
Adjusted EBITDA	<u>\$ 5.0</u>	<u>\$ 8.4</u>	<u>\$ (0.2)</u>	<u>\$ 38.5</u>

- (a) This adjustment is comprised of all items included in the restructuring and impairment charges line item on our consolidated statements of operations, and eliminates the impact of restructuring charges of \$1.8 million related to the restructuring of our six-inch fabrication facilities, and the impact of impairment charges of \$0.6 million related to the impairment of certain existing technology for the nine months ended September 30, 2013.
- (b) This adjustment eliminates the impact of non-cash equity-based compensation expenses. Although we expect to incur non-cash equity-based compensation expenses in the future, we believe that analysts and investors will find it helpful to review our operating performance without the effects of these non-cash expenses, as supplemental information.
- (c) This adjustment eliminates the impact of non-cash foreign currency translation associated with intercompany debt obligations and foreign currency denominated receivables and payables, as well as the cash impact of foreign currency transaction gains or losses on collection of such receivables and payment of such payables. Although we expect to incur foreign currency translation gains or losses in the future, we believe that analysts and investors will find it helpful to review our operating performance without the effects of these primarily non-cash gains or losses, as supplemental information.
- (d) This adjustment eliminates the impact of gain or loss recognized in income on derivatives, which represents hedge ineffectiveness or derivatives value changes excluded from the risk being hedged. We enter into derivative transactions to mitigate foreign exchange risks. As our derivative transactions are limited to a certain portion of our expected cash flows denominated in U.S. dollars, and we do not enter into derivative transactions for trading or speculative purposes, we do not believe that these charges or gains are indicative of our core operating performance.
- (e) This adjustment eliminates expenses incurred for our secondary offerings in September 2013 and February 2013.
- (f) This adjustment eliminates the impact of loss on repayment of \$203.7 million aggregate principal amount of our 2018 Notes for the three months and the nine months ended September 30, 2013, respectively.
- (g) This adjustment eliminates non-recurring expenses incurred in connection with the Audit Committee's independent investigation and related restatement, which are primarily comprised of legal and consulting fees.

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

- Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;
- Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;
- Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;

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- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;
- Adjusted EBITDA does not consider the potentially dilutive impact of issuing equity-based compensation to our management team and employees;
- Adjusted EBITDA does not reflect the costs of holding certain assets and liabilities in foreign currencies; and
- other companies in our industry may calculate Adjusted EBITDA differently than we do, limiting its usefulness as a comparative measure.

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

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

- we use Adjusted Net Income in communications with our Board concerning our consolidated financial performance;
- we believe that Adjusted Net Income is an enterprise level performance measure commonly reported and widely used by analysts and investors in our industry; and
- our investor and analyst presentations will include Adjusted Net Income.

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

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

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014	Three Months Ended September 30, 2013 <u>As Restated</u>	Nine Months Ended September 30, 2013 <u>As Restated</u>
(In millions)				
Net income (loss)	\$ (46.8)	\$ (53.4)	\$ 0.3	\$ (42.0)
Adjustments:				
Restructuring and impairment charges(a)	—	—	—	2.4
Equity-based compensation expense(b)	0.6	1.7	0.5	1.6
Amortization of intangibles(c)	0.4	1.1	1.5	4.7
Foreign currency loss (gain), net(d)	23.5	(5.5)	(47.1)	(1.5)
Derivative valuation loss (gain), net(e)	—	0.1	(0.7)	(0.2)
Secondary offering and others(f)	—	—	0.5	1.4
Loss on early extinguishment of senior notes(g)	—	—	32.8	32.8
Restatement related expenses(h)	15.5	28.8	—	—
Adjusted Net Loss	<u>\$ (6.8)</u>	<u>\$ (27.3)</u>	<u>\$ (12.1)</u>	<u>\$ (0.7)</u>

- (a) This adjustment is comprised of all items included in the restructuring and impairment charges line item on our consolidated statements of operations, and eliminates the impact of restructuring charges of \$1.8 million related to the restructuring of our six-inch fabrication facilities, and the impact of impairment charges of \$0.6 million related to the impairment of certain existing technology for the nine months ended September 30, 2013.

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- (b) This adjustment eliminates the impact of non-cash equity-based compensation expenses. Although we expect to incur non-cash equity-based compensation expenses in the future, we believe that analysts and investors will find it helpful to review our operating performance without the effects of these non-cash expenses, as supplemental information.
- (c) This adjustment eliminates the non-cash impact of amortization expense for intangible assets created as a result of the purchase accounting treatment of the Original Acquisition and other subsequent acquisitions, and from the application of fresh-start accounting in connection with the reorganization proceedings. We do not believe these non-cash amortization expenses for intangibles are indicative of our core ongoing operating performance because the assets would not have been capitalized on our balance sheet but for the application of purchase accounting or fresh-start accounting, as applicable.
- (d) This adjustment eliminates the impact of non-cash foreign currency translation associated with intercompany debt obligations and foreign currency denominated receivables and payables, as well as the cash impact of foreign currency transaction gains or losses on collection of such receivables and payment of such payables. Although we expect to incur foreign currency translation gains or losses in the future, we believe that analysts and investors will find it helpful to review our operating performance without the effects of these primarily non-cash gains or losses, as supplemental information.
- (e) This adjustment eliminates the impact of gain or loss recognized in income on derivatives, which represents hedge ineffectiveness or derivatives value changes excluded from the risk being hedged. We enter into derivative transactions to mitigate foreign exchange risks. As our derivative transactions are limited to a certain portion of our expected cash flows denominated in U.S. dollars, and we do not enter into derivative transactions for trading or speculative purposes, we do not believe that these charges or gains are indicative of our core operating performance.
- (f) This adjustment eliminates expenses incurred for our secondary offerings in September 2013 and February 2013.
- (g) This adjustment eliminates the impact of loss on repayment of \$203.7 million aggregate principal amount of our 2018 Notes for the three months and the nine months ended September 30, 2013, respectively.
- (h) This adjustment eliminates non-recurring expenses incurred in connection with the Audit Committee's independent investigation and related restatement, which are primarily comprised of legal and consulting fees.

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

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

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

Factors Affecting Our Results of Operations

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

We recognize revenue when risk and reward of ownership pass to the customer either upon shipment, upon product delivery at the customer's location or upon customer acceptance, depending on the terms of the arrangement. For the nine months ended September 30, 2014 and 2013, we sold products to over 258 and 263 customers, respectively, and our net sales to our ten largest customers represented 60% and 61% of our net sales, respectively. We have a combined production capacity of over 131,467 eight-inch equivalent semiconductor wafers per month. We believe our large-scale, cost-effective fabrication facilities enable us to rapidly adjust our production levels to meet shifts in demand by our end customers.

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

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

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

Labor Costs. A significant portion of our employees are located in Korea. Under Korean labor laws, most employees and certain executive officers with one or more years of service are entitled to severance benefits upon the termination of their employment based on their length of service and rate of pay. As of September 30, 2014, approximately 98% of our employees were eligible for severance benefits.

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

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

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

Research and Development. The rapid technological change and product obsolescence that characterize our industry require us to make continuous investments in research and development. Product development time frames vary but, in general, we incur research and development costs one to two years before generating sales from the associated new products. These expenses include personnel costs for members of our engineering workforce, cost of photomasks, silicon wafers and other non-recurring engineering charges related to product design. Additionally, we develop base-line process technology through experimentation and through the design and use of characterization wafers that help achieve commercially feasible yields for new products. The majority of research and development expenses are for process development that serves as a common technology platform for all of our product lines. Consequently, we do not allocate these expenses to individual lines.

Restructuring and Impairment Charges. We evaluate the recoverability of certain long-lived assets and in-process research and development assets on a periodic basis or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In our efforts to improve our overall profitability in future periods, we have closed or otherwise impaired, and may in the future close or impair, facilities that are underutilized and that are no longer aligned with our long-term business goals.

Interest Expense, Net. Our interest expense was incurred primarily under the 2018 Notes and the 2021 Notes.

Impact of Foreign Currency Exchange Rates on Reported Results of Operations. Historically, a portion of our revenues and greater than the majority of our operating expenses and costs of sales have been denominated in non-U.S. currencies, principally the Korean won, and we expect that this will remain true in the future. Because we report our results of operations in U.S. dollars converted from our non-U.S. revenues and expenses based on monthly average exchange rates, changes in the exchange rate between the Korean won and the U.S. dollar could materially impact our reported results of operations and distort period to period comparisons. In particular, because of the difference in the amount of our consolidated revenues and expenses that are in U.S. dollars relative to Korean won, depreciation in the U.S. dollar relative to the Korean won could result in a material increase in reported costs relative to revenues, and therefore could cause our profit margins and operating income (loss) to appear to decline materially, particularly relative to prior periods. The converse is true if the U.S. dollar were to appreciate relative to the Korean won. As a result

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of such foreign currency fluctuations, it could be more difficult to detect underlying trends in our business and results of operations. In addition, to the extent that fluctuations in currency exchange rates cause our results of operations to differ from our expectations or the expectations of our investors, the trading price of our stock could be adversely affected.

From time to time, we may engage in exchange rate hedging activities in an effort to mitigate the impact of exchange rate fluctuations. Our Korean subsidiary periodically enters into foreign currency option, forward and zero cost collar contracts in order to mitigate a portion of the impact of U.S. dollar-Korean won exchange rate fluctuations on our operating results. Obligations under these foreign currency option, forward and zero cost collar contracts must be cash collateralized if our exposure exceeds certain specified thresholds. We cannot assure that any hedging technique we implement will be effective. If our hedging activities are not effective, changes in currency exchange rates may have a more significant impact on our results of operations.

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

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

Our operations are subject to income and transaction taxes in the United States and in multiple foreign jurisdictions, including Korea. Significant estimates and judgments are required in determining our worldwide provision for income taxes. Some of these estimates are based on interpretations of existing tax laws or regulations. The ultimate amount of tax liability may be uncertain as a result.

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

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

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Results of Operations – Comparison of Three Months Ended September 30, 2014 and 2013

The following table sets forth consolidated results of operations for the three months ended September 30, 2014 and 2013:

	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013 As Restated		Change Amount
	Amount	% of Net Sales	Amount	% of Net Sales	
	(In millions)				
Net sales	\$ 194.3	100.0%	\$ 170.8	100.0%	\$ 23.5
Cost of sales	151.7	78.1	136.4	79.9	15.3
Gross profit	42.6	21.9	34.4	20.1	8.2
Selling, general and administrative expenses	38.7	19.9	22.2	13.0	16.5
Research and development expenses	23.4	12.1	22.5	13.2	0.9
Operating loss	(19.5)	(9.9)	(10.2)	(6.0)	(9.3)
Interest expense, net	(4.1)	(2.1)	(4.5)	(2.7)	0.5
Foreign currency gain (loss), net	(23.5)	(12.1)	47.1	27.6	(70.6)
Loss on early extinguishment of senior notes	—	—	(32.8)	(19.2)	32.8
Others	0.6	0.3	1.2	0.8	(0.6)
	(27.0)	(13.9)	10.9	6.4	(38.0)
Loss before income taxes	(46.5)	(23.9)	0.7	0.5	(47.2)
Income tax expenses	0.3	0.2	0.5	0.3	(0.2)
Net loss	\$ (46.8)	(24.1)%	\$ 0.3	0.1%	\$ (47.1)

Net Sales

	Three Months Ended September 30, 2014		Three Months Ended September 30, 2013 As Restated		Change Amount
	Amount	% of Net Sales	Amount	% of Net Sales	
	(In millions)				
Display Solutions	\$ 58.7	30.2%	\$ 44.1	25.8%	\$ 14.6
Power Solutions	36.1	18.6	36.4	21.3	(0.3)
Semiconductor Manufacturing Services	99.3	51.1	90.3	52.8	9.1
All other	0.2	—	0.1	0.1	0.1
	\$ 194.3	100.0%	\$ 170.8	100.0%	\$ 23.5

Net sales were \$194.3 million for the three months ended September 30, 2014, a \$23.5 million, or 13.8%, increase, compared to \$170.8 million for the three months ended September 30, 2013. Net sales increased primarily due to the increase in net sales from our Display Solutions line and Semiconductor Manufacturing Services line.

Display Solutions. Net sales from our Display Solutions line were \$58.7 million for the three months ended September 30, 2014, a \$14.6 million, or 33.1%, increase from \$44.1 million for the three months ended September 30, 2013. The increase in sales volume contributed 10% increase in revenue, and the increase in average selling prices contributed 21% increase in revenue. The significant increase in sales volume of mobile display products positively impacted our overall revenue and sales volume. The sales volume of large display products was approximately flat.

Power Solutions. Net sales from our Power Solutions line were \$36.1 million for the three months ended September 30, 2014, a \$0.3 million, or 0.8%, decrease from \$36.4 million for the three months ended September 30, 2013. The decrease in sales volume led to 16% decline in revenue, partially offset by the increase in average selling prices, which contributed 12% increase in revenue. The revenue for MOSFET products declined, nearly offset by the increase in revenue for premium products.

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Semiconductor Manufacturing Services. Net sales from our Semiconductor Manufacturing Services line were \$99.3 million for the three months ended September 30, 2014, a \$9.1 million, or 10.0%, increase compared to \$90.3 million for the three months ended September 30, 2013. The increase in sales volume contributed 12% increase in revenue, but the decrease in average selling prices led to 4% decline in revenue. This increase was primarily due to an increase in sales volume of eight-inch equivalent wafers driven by higher market demand.

All Other. All other net sales were \$0.2 million for the three months ended September 30, 2014 and \$0.1 million for the three months ended September 30, 2013.

Net Sales by Geographic Region

The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the three months ended September 30, 2014 and 2013:

	<u>Three Months Ended September 30, 2014</u>		<u>Three Months Ended September 30, 2013</u>		<u>Change Amount</u>
	<u>Amount</u>	<u>% of Net Sales</u>	<u>Amount</u>	<u>% of Net Sales</u>	
	(In millions)				
Korea	\$ 84.8	43.6%	\$ 74.1	43.4%	\$ 10.7
Asia Pacific (other than Korea)	80.1	41.2	68.5	40.1	11.6
United States	25.1	12.9	22.8	13.3	2.3
Europe	3.8	2.0	4.5	2.6	(0.7)
Others	0.5	0.3	1.0	0.6	(0.4)
	<u>\$ 194.3</u>	100.0%	<u>\$ 170.8</u>	100.0%	<u>\$ 23.5</u>

Net sales in Korea increased from \$74.1 million for the three months ended September 30, 2013 to \$84.8 million for the three months ended September 30, 2014, or by \$10.7 million, or 14.5%, due to the increase in demand for our products for mobile devices and stabilization of demand for our products for large display applications. Net sales in Asia Pacific increased from \$68.5 million for the three months ended September 30, 2013 to \$80.1 million for the three months ended September 30, 2014, or by \$11.6 million, or 17.0%, primarily due to increases in net sales of our Semiconductor Manufacturing Services division. Net sales in the United States increased from \$22.8 million for the three months ended September 30, 2013 to \$25.1 million for the three months ended September 30, 2014, or by \$2.3 million, or 10.1%, due to the increase in demand for our products for mobile devices.

Gross Profit

Total gross profit was \$42.6 million for the three months ended September 30, 2014 compared to \$34.4 million for the three months ended September 30, 2013, a \$8.2 million, or 23.9%, increase. Gross profit as a percentage of net sales for the three months ended September 30, 2014 increased to 21.9% compared to 20.1% for the three months ended September 30, 2013.

The increase in gross profit was primarily due to the positive impact on the gross profit for the three months ended September 30, 2014 from the change in inventory reserve and write off, compared to the prior year period. The decrease in inventory reserve was \$0.4 million for the three months ended September 30, 2014, compared to the increase of \$17.5 million for the three months ended September 30, 2013. An increase in inventory reserve reduces gross profit. The inventory write-off, which is recognized only when the related inventory has been disposed or scrapped, was \$8.0 million, for the three months ended September 30, 2014, compared to \$0.6 million for the three months ended September 30, 2013.

The factors described above were offset by the negative impact of a lower utilization rate and increases in our labor and electricity costs on the gross profit for the three months ended September 30, 2014 compared to the three months ended September 30, 2013. Reduced levels of customer orders experienced by the Semiconductor Manufacturing Services division resulted in the low utilization rates. The labor and benefits costs increased as a result of an increase in the average salary. Increases in the electricity tariffs by Korea Electric Power Corporation resulted in higher electricity costs.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general and administrative expenses were \$38.7 million, or 19.9% of net sales, for the three months ended September 30, 2014, compared to \$22.2 million, or 13.0% of net sales, for the three months ended September 30, 2013. The increase of \$16.5 million, or 74.6%, was primarily attributable the increase in outside service fees related to the Audit Committee's independent investigation and related restatement.

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Research and Development Expenses. Research and development expenses were \$23.4 million, or 12.1% of net sales, for the three months ended September 30, 2014, compared to \$22.5 million, or 13.2% of net sales, for the three months ended September 30, 2013. The increase of \$0.9 million, or 4.2%, was primarily due to an increase in direct material costs related to ongoing research and development activities.

Operating Loss

As a result of the foregoing, operating loss increased by \$9.3 million, or 90.6%, in the three months ended September 30, 2014 compared to the three months ended September 30, 2013. As discussed above, the increase in operating loss resulted from a \$16.5 million increase in selling, general and administrative expenses and a \$0.9 million increase in research and development expenses, which were partially offset by a \$8.2 million increase in gross profit.

Other Income (Expense)

Interest Expense, Net. Net interest expense was \$4.1 million for the three months ended September 30, 2014, a decrease of \$0.5 million compared to \$4.5 million for the three months ended September 30, 2013. The decrease of \$0.5 million was primarily due to the repayment of our 2018 Notes and the issuance of our 2021 Notes.

Foreign Currency Gain, Net. Net foreign currency loss for the three months ended September 30, 2014 was \$23.5 million compared to net foreign currency gain of \$47.1 million for the three months ended September 30, 2013. A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss associated with intercompany balances at our Korean subsidiary and is affected by changes in the exchange rate between the Korean won and the U.S. dollar. Foreign currency translation gain from intercompany balances was included in determining our consolidated net income since the intercompany balances were not considered long-term investments in nature because management intended to settle these intercompany balances at their respective maturity dates.

Loss on Early Extinguishment of Senior Notes. In August 2013, we repaid \$203.7 million aggregate principal amount of our 2018 Notes. In relation with this repayment, we recognized \$32.8 million of loss on the early extinguishment of senior notes.

Others. Others were comprised of gains and losses on valuation of derivatives which were designated as hedging instruments. Net gain on valuation of derivatives for the nine months ended September 30, 2014 represents either hedge ineffectiveness or components of changes in fair value of derivatives excluded from the assessments of hedge effectiveness.

Income Tax Expenses

Income tax expenses for the three months ended September 30, 2014 and 2013 were \$0.3 million and \$0.5 million, respectively, primarily attributable to withholding taxes related to the intercompany balances and net operating loss carry-back in the parent company and a domestic subsidiary.

Net Loss

As a result of the foregoing, net loss increased by \$47.1 million in the three months ended September 30, 2014 compared to the three months ended September 30, 2013. As discussed above, the decrease primarily resulted from a \$70.6 million increase in foreign currency loss, partially offset by a \$32.8 million loss on early extinguishment of senior notes.

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Results of Operations – Comparison of Nine Months Ended September 30, 2014 and 2013

The following table sets forth consolidated results of operations for the nine months ended September 30, 2014 and 2013:

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013 As Restated		Change Amount
	Amount	% of Net Sales	Amount	% of Net Sales	
	(In millions)				
Net sales	\$ 530.6	100.0%	\$ 558.7	100.0%	\$ (28.1)
Cost of sales	412.2	77.7	420.8	75.3	(8.6)
Gross profit	118.4	22.3	137.9	24.7	(19.5)
Selling, general and administrative expenses	94.5	17.8	63.9	11.4	30.5
Research and development expenses	70.6	13.3	65.1	11.7	5.5
Restructuring and impairment charges	—	—	2.4	0.4	(2.4)
Operating income (loss)	(46.7)	(8.8)	6.4	1.1	(53.1)
Interest expense, net	(12.2)	(2.3)	(16.3)	(2.9)	4.1
Foreign currency gain, net	5.5	1.0	1.5	0.3	4.0
Loss on early extinguishment of senior notes	—	—	(32.8)	(5.9)	32.8
Others	1.7	0.3	1.9	0.3	(0.1)
	(4.9)	(0.9)	(45.7)	(8.2)	40.8
Loss before income taxes	(51.6)	(9.7)	(39.3)	(7.0)	(12.3)
Income tax expenses	1.8	0.3	2.7	0.5	(0.9)
Net loss	\$ (53.4)	(10.1)%	\$ (42.0)	(7.5)%	\$ (11.4)

Net Sales

	Nine Months Ended September 30, 2014		Nine Months Ended September 30, 2013		Change Amount
	Amount	% of Net Sales	Amount	% of Net Sales	
	(In millions)				
Display Solutions	\$ 144.4	27.2%	\$ 160.1	28.7%	\$ (15.7)
Power Solutions	104.1	19.6	93.6	16.7	10.6
Semiconductor Manufacturing Services	281.6	53.1	304.7	54.5	(23.1)
All other	0.4	0.1	0.3	0.1	0.1
	\$ 530.6	100.0%	\$ 558.7	100.0%	\$ (28.1)

Net sales were \$530.6 million for the nine months ended September 30, 2014, a \$28.1 million, or 5.0%, decrease, compared to \$558.7 million for the nine months ended September 30, 2013. Net sales decreased primarily due to the decrease in net sales from our Display Solutions line and Semiconductor Manufacturing Services line, as described below, offset by an increase in net sales from our Power Solutions line.

Display Solutions. Net sales from our Display Solutions line were \$144.4 million for the nine months ended September 30, 2014, a \$15.7 million, or 9.8%, decrease from \$160.1 million for the nine months ended September 30, 2013. The decrease in sales volume contributed 23% decrease in revenue, and the increase in average selling prices contributed 12% increase in revenue. The increase in sales volume of mobile display products positively impacted our overall revenue and sales volume. The sales volume of large display products declined significantly during the first six months of 2014, before recovering during the third quarter of 2014.

Power Solutions. Net sales from our Power Solutions line were \$104.1 million for the nine months ended September 30, 2014, a \$10.6 million, or 11.3%, increase from \$93.6 million for the nine months ended September 30, 2013. The increase in sales volume contributed 11% increase in revenue, and the decrease in average selling prices contributed 2% decrease in revenue. The significant increase in sales volume of premium products positively impacted our overall revenue and sales volume. The sales volume of MOSFET products increased slightly.

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Semiconductor Manufacturing Services. Net sales from our Semiconductor Manufacturing Services line were \$281.6 million for the nine months ended September 30, 2014, a \$23.1 million, or 7.6%, decrease compared to net sales of \$304.7 million for the nine months ended September 30, 2013. The decrease in sales volume contributed 6% decrease in revenue, and the decrease in average selling prices contributed 3% decrease in revenue. The sales volume of our six-inch facility declined significantly.

All Other. All other net sales were \$0.4 million for the nine months ended September 30, 2014 and \$0.3 million for the nine months ended September 30, 2013.

Net Sales by Geographic Region

The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the nine months ended September 30, 2014 and 2013:

	<u>Nine Months Ended September 30, 2014</u>		<u>Nine Months Ended September 30, 2013</u>		<u>Change Amount</u>
	<u>Amount</u>	<u>% of Net Sales</u>	<u>Amount</u>	<u>% of Net Sales</u>	
	(In millions)				
Korea	\$ 219.1	41.3%	\$ 239.1	42.8%	\$ (20.0)
Asia Pacific (other than Korea)	224.7	42.3	209.2	37.4	15.5
United States	69.4	13.1	78.5	14.1	(9.1)
Europe	16.3	3.1	29.1	5.2	(12.8)
Others	1.0	0.2	2.7	0.5	(1.7)
	<u>\$ 530.6</u>	100.0%	<u>\$ 558.7</u>	100.0%	<u>\$ (28.1)</u>

Net sales in Korea declined from \$239.1 million for the nine months ended September 30, 2013 to \$219.1 million for the nine months ended September 30, 2014, or by \$20.0 million, or 8.4%, primarily due to the decline in demand for our products for large display applications. Net sales in Asia Pacific increased from \$209.2 million for the nine months ended September 30, 2013 to \$224.7 million for the nine months ended September 30, 2014, or by \$15.5 million, or 7.4%, primarily due to increases in net sales of Semiconductor Manufacturing Services and Power Solutions divisions. Net sales in the United States declined from \$78.5 million for the nine months ended September 30, 2013 to \$69.4 million for the nine months ended September 30, 2014, or by \$9.1 million, or 11.6%, due to the decline in demand for our products for mobile devices. Net sales in Europe declined from \$29.1 million for the nine months ended September 30, 2013 to \$16.3 million for the nine months ended September 30, 2014, or by \$12.8 million, or 43.9%, due to the decline in demand for our products for mobile devices.

Gross Profit

Total gross profit was \$118.4 million for the nine months ended September 30, 2014 compared to \$137.9 million for the nine months ended September 30, 2013, a \$19.5 million, or 14.2%, decrease. Gross profit as a percentage of net sales for the nine months ended September 30, 2014 was 22.3% compared to 24.7% for the nine months ended September 30, 2013.

The decline in the gross profit was primarily attributable to the negative impact of a lower utilization rate and increases in our labor and electricity costs on the gross profit for the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. Reduced levels of customer orders experienced by the Semiconductor Manufacturing Services division resulted in the low utilization rates. The labor and benefits costs increased as a result of an increase in the average salary. Increases in the electricity tariffs by Korea Electric Power Corporation resulted in higher electricity costs.

The factors described above were offset by the positive impact on the gross profit for the nine months ended September 30, 2014 from the change in inventory reserve and write off, compared to the prior year period. The increase in inventory reserve was \$3.0 million for the nine months ended September 30, 2014, compared to the increase of \$31.8 million for the nine months ended September 30, 2013. An increase in inventory reserve reduces gross profit. The inventory write off, which is recognized only when the related inventory has been disposed or scrapped, was \$20.7 million for the nine months ended September 30, 2014, compared to \$1.1 million for the nine months ended September 30, 2013.

Operating Expenses

Selling, General and Administrative Expenses. Selling, general, and administrative expenses were \$94.5 million, or 17.8% of net sales, for the nine months ended September 30, 2014, compared to \$63.9 million, or 11.4% of net sales, for the nine months ended September 30, 2013. The increase of \$30.5 million, or 47.8%, was primarily attributable to the increase in outside service fees related to the Audit Committee's independent investigation and related restatement.

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Research and Development Expenses. Research and development expenses were \$70.6 million, or 13.3% of net sales, for the nine months ended September 30, 2014, compared to \$65.1 million, or 11.7% of net sales, for the nine months ended September 30, 2013. The increase of \$5.5 million, or 8.4%, was due to an increase in direct material costs related to ongoing research and development activities and an increase in personnel costs.

Restructuring and Impairment Charges. We had no restructuring and impairment charges for the nine months ended September 30, 2014 compared to \$2.4 million for the nine months ended September 30, 2013. Restructuring charges of \$1.8 million recorded for the nine months ended September 30, 2013 were related to the restructuring of one of our fabrication facilities. Impairment charges of \$0.6 million for the nine months ended September 30, 2013 consisted of impairments to certain existing technology.

Operating Income

As a result of the foregoing, operating income decreased by \$53.1 million, in the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. As discussed above, the decrease in operating income resulted from a \$19.5 million decrease in gross profit, which was offset by a \$30.5 million increase in selling, general and administrative expenses and a \$5.5 million increase in research and development expenses.

Other Income (Expense)

Interest Expense, Net. Net interest expense was \$12.2 million for the nine months ended September 30, 2014, a decrease of \$4.1 million compared to \$16.3 million for the nine months ended September 30, 2013. The decrease of \$4.1 million was primarily due to the repayment of our 2018 Notes and the issuance of our 2021 Notes in 2013.

Foreign Currency Gain (Loss), Net. Net foreign currency gain for the nine months ended September 30, 2014 was \$5.5 million compared to \$1.5 million for the nine months ended September 30, 2013. A substantial portion of our net foreign currency gain or loss is non-cash translation gain or loss associated with intercompany balances at our Korean subsidiary and is affected by changes in the exchange rate between the Korean won and the U.S. dollar. Foreign currency translation gain from intercompany balances was included in determining our consolidated net income since the intercompany balances were not considered long-term investments in nature because management intended to settle these intercompany balances at their respective maturity dates.

Loss on Early Extinguishment of Senior Notes. In August 2013, we repaid \$203.7 million aggregate principal amount of our 2018 Notes. In relation with this repayment, we recognized \$32.8 million of loss on the early extinguishment of senior notes.

Others. Others were comprised of gains and losses on valuation of derivatives which were designated as hedging instruments. Net gain on valuation of derivatives for the nine months ended September 30, 2014 represents either hedge ineffectiveness or components of changes in fair value of derivatives excluded from the assessments of hedge effectiveness.

Income Tax Expenses

Income tax expenses for the nine months ended September 30, 2014 and 2013 were \$1.8 million and \$2.7 million, respectively, primarily attributable to withholding taxes related to the intercompany balances and net operating loss carry-back in the parent company and a domestic subsidiary.

Net Loss

As a result of the foregoing, net loss increased by \$11.4 million, or 27.1%, in the nine months ended September 30, 2014 compared to the nine months ended September 30, 2013. As discussed above, the decrease primarily resulted from a \$53.1 increase in operating loss, partially offset by a \$32.8 million loss on early extinguishment of senior notes.

Liquidity and Capital Resources

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

Our principal sources of liquidity are our cash, cash equivalents and our cash flows from operations and our financing activities. Our ability to manage cash and cash equivalents may be limited as our primary cash flows are dictated by the terms of our sales and supply agreements, contractual obligations, debt instruments and legal and regulatory requirements. From time to time, we may sell accounts receivable to third parties under factoring agreements or engage in accounts receivable discounting to facilitate the collection of cash. In addition, from time to time, we may make payments to our vendors on extended terms with their consent.

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Cash Flows from Operating Activities

Cash outflows used in operating activities totaled \$10.3 million for the nine months ended September 30, 2014, compared to \$49.4 million of cash provided by operating activities in the nine months ended September 30, 2013. The net operating cash outflow for the nine months ended September 30, 2014 reflects our net loss of \$53.4 million and non-cash adjustments of \$38.8 million which mainly consisted of depreciation and amortization and provision for severance benefits, and a decrease in net operating assets of \$4.2 million.

Our working capital balance as of September 30, 2014 was \$131.8 million compared to \$172.1 million as of December 31, 2013. The \$40.3 million decrease was primarily attributable to a \$28.4 million decrease in cash and cash equivalents and a \$11.9 million increase in accrued expenses, primarily as a result of accrual of outside service fees related to the Audit Committee's independent investigation and related restatement.

Cash Flows from Investing Activities

Cash outflow used in investing activities totaled \$14.7 million in the nine months ended September 30, 2014, compared to \$41.6 million of cash outflow used in investing activities in the nine months ended September 30, 2013. The decrease was primarily due to a decrease in capital expenditures of \$24.6 million.

Cash Flows from Financing Activities

Cash inflows generated by financing activities totaled \$0.1 million for the nine months ended September 30, 2014, compared to \$31.8 million of cash outflow used in financing activities in the nine months ended September 30, 2013. The financing cash outflow for the nine months ended September 30, 2013 mainly consists of the repayment of \$229.3 million of our 2018 Notes and the repurchase of \$31.0 million of our outstanding common stock, which were offset by \$9.7 million of proceed received from the issuance of common stock in connection with option and warrant exercises and the net proceeds of \$218.8 million from the issuance of our 2021 Notes. We repurchased 1,589,401 shares of common stock at a cost of \$31.0 million for the nine months ended September 30, 2013.

Capital Expenditures

We routinely make capital expenditures to enhance our existing facilities and reinforce our global research and development capability. For the nine months ended September 30, 2014, capital expenditures were \$16.4 million, a \$24.6 million, or 60.0%, decrease from \$41.0 million in the nine months ended September 30, 2013 primarily due to comparatively larger technology upgrade investments in 2013.

Seasonality

Our net sales and number of distinct products sold are affected by market variations from quarter to quarter due to business cycles, and resulting product demand, of our customers. In our Display Solutions and Power Solutions business lines, consumer products manufacturers generally reduce orders in order to reduce excess inventory remaining from the holiday season. In our Semiconductor Manufacturing Services business, the supply-demand cycle is usually one quarter ahead of the broader semiconductor market due to lead time from wafer input to shipment to our customers, so the demand for these products tends to peak in the third quarter and is slower in the fourth and first quarters.

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Contractual Obligations

The following summarizes our contractual obligations as of September 30, 2014:

	Payments Due by Period						
	Total	Remainder of 2014	2015	2016	2017	2018	Thereafter
Senior notes ⁽¹⁾	\$329.3	\$ —	\$14.9	\$14.9	\$14.9	\$14.9	\$ 269.7
Operating lease ⁽²⁾	53.0	4.7	5.7	4.7	2.3	2.2	33.4
Others ⁽³⁾	13.0	0.9	7.6	3.9	0.5	—	—

- (1) Interest payments as well as \$225.0 million aggregate principal amount of the 2021 Notes outstanding as of September 30, 2014, which bear interest at a rate of 6.625% per annum and are scheduled to mature in 2021.
- (2) Assumes constant currency exchange rate for Korean won to U.S. dollars of 1,050.6:1.
- (3) Includes license agreements and other contractual obligations.

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

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

We follow ASC guidance on uncertain tax positions. Our unrecognized tax benefits totaled \$3.7 million as of September 30, 2014. These unrecognized tax benefits have been excluded from the above table because we cannot estimate the period of cash settlement with the respective taxing authorities.

Critical Accounting Policies and Estimates

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

We believe that our significant accounting policies, which are described in Note 1 to the consolidated financial statements of MagnaChip Semiconductor Corporation for the nine months ended September 30, 2014 included elsewhere in this Report, are critical due to the fact that they involve a high degree of judgment and estimates about the effects of matters that are inherently uncertain. We base these estimates and judgments on historical experience, knowledge of current conditions and other assumptions and information that we believe to be reasonable. Estimates and assumptions about future events and their effects cannot be determined with certainty. Accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the business environment in which we operate changes.

Revenue Recognition

Revenue is recognized when there is persuasive evidence of an arrangement, the price to the buyer is fixed or determinable, delivery has occurred and collectability of the sales price is reasonably assured. Revenue from the sale of products is recognized when title and risk of loss transfers to the customer, which is generally when the product is shipped to or accepted by the customer depending on the terms of the arrangement.

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A portion of our sales are made through distributors for which revenue recognition criteria are usually met when the product is shipped to or accepted by the distributor, consistent with the principles described above. However, the risk of loss may not pass upon shipment of products to the distributors due to a variety of reasons, including the nature of the business arrangement with the distributor. For example, the financial condition of a distributor may indicate that payments by the distributor to us are contingent on resale of products to an end customer. In this situation, we defer recognition of revenue and cost of revenue on transactions with such distributor until we are informed by the distributor that the product has been resold to the end customer.

In accordance with revenue recognition guidance, any tax assessed by a governmental authority that is directly imposed on a revenue-producing transaction between a seller and a customer is presented in the statements of operations on a net basis (excluded from revenues).

We provide a warranty, under which customers can return defective products. We estimate the costs related to those defective product returns and record them as a component of cost of sales.

In addition, we offer sales returns (other than those that relate to defective products under warranty), yield provisions, cash discounts for early payments and certain allowances to our customers, including distributors. We record reserves for those returns, discounts and allowances as a deduction from sales, based on historical experience and other quantitative and qualitative factors.

All amounts billed to a customer related to shipping and handling are classified as sales while all costs incurred by us for shipping and handling are classified as selling, general and administrative expenses.

Sales of Accounts Receivable

We account for transfers of financial assets under ASC 860, "Transfers and Servicing," as either sales or financings. Transfers of financial assets that result in sales accounting are those in which (1) the transfer legally isolates the transferred assets from the transferor, (2) the transferee has the right to pledge or exchange the transferred assets and no condition both constrains the transferee's right to pledge or exchange the assets and provides more than a trivial benefit to the transferor, and (3) the transferor does not maintain effective control over the transferred assets. If the transfer does not meet these criteria, the transfer is accounted for as a financing. Financial assets that are treated as sales are removed from our accounts with any realized gain or loss reflected in earnings during the period of sale.

Product Warranties

We record, in other current liabilities, warranty liabilities for the estimated costs that may be incurred under our basic limited warranty. The standard limited warranty period is one year for the majority of products. This warranty covers defective products, and related liabilities are accrued when product revenues are recognized. Factors that affect our warranty liability include historical and anticipated rates of warranty claims and repair or replacement costs per claim to satisfy our warranty obligation. As these factors are impacted by actual experience and future expectations, we periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts when necessary.

Inventories

Inventories are stated at the lower of cost or market, using the average cost method, which approximates the first in, first out method ("FIFO"). If net realizable value is less than cost at the balance sheet date, the carrying amount is reduced to the realizable value, and the difference is recognized as a loss on valuation of inventories within cost of sales. Inventory reserves are established when conditions indicate that the net realizable value is less than costs due to physical deterioration, obsolescence, changes in price levels, or other causes based on individual facts and circumstances. Reserves are also established for excess inventory based on inventory levels in excess of six months of projected demand for each specific product.

In addition, as prescribed in ASC 330, "Inventory," the cost of inventories is determined based on the normal capacity of each fabrication facility. In case the capacity utilization is lower than a certain level that management believes to be normal, the fixed overhead costs per production unit which exceed those under normal capacity are charged to cost of sales rather than capitalized as inventories.

Impairment of Long-Lived Assets

We review property, plant and equipment and other long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable in accordance with ASC 360, "Property, Plant and Equipment" ("ASC 360"). Recoverability is measured by comparing its carrying amount with the future net undiscounted cash flows

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the assets are expected to generate. If such assets are considered to be impaired, the impairment is measured as the difference between the carrying amount of the assets and the fair value of assets using the present value of the future net cash flows generated by the respective long-lived assets.

Intangible Assets

Intangible assets other than intellectual property include technology and customer relationships which are amortized on a straight-line basis over periods ranging from one to five years. Intellectual property assets acquired represent rights under patents, trademarks and property use rights and are amortized over their respective periods of benefit, ranging up to ten years, on a straight-line basis.

Income Taxes

Prior to its conversion to a corporation, MagnaChip Semiconductor LLC elected to be treated as a partnership for United States federal income tax purposes and therefore was not subject to income taxes on its income. Taxes on its income were the responsibility of the individual equity owners of MagnaChip Semiconductor LLC. MagnaChip Semiconductor Corporation became a taxable entity according to the corporate conversion in March 2011. We operate a number of subsidiaries that are subject to local income taxes in those territories.

We account for income taxes in accordance with ASC 740, "Income Taxes" ("ASC 740"). ASC 740 requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in a company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based upon the difference between the financial statement carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse. Valuation allowances are established when it is necessary to reduce deferred tax assets to the amount expected to be realized. Income tax expense is the tax payable for the period and the change during the period in deferred tax assets and liabilities.

We recognize and measure uncertain tax positions taken or expected to be taken in a tax return utilizing a two-step process. In the first step, recognition, we determine whether it is more-likely-than-not that a tax position will be sustained upon examination, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The second step addresses measurement of a tax position that meets the more-likely-than-not criteria. The tax position is measured at the largest amount of benefit that has a likelihood of greater than 50 percent of being realized upon ultimate settlement.

Derivative Financial Instruments

We apply the provisions of ASC 815, "Derivatives and Hedging" ("ASC 815"). This Statement requires the recognition of all derivative instruments as either assets or liabilities measured at fair value.

Under the provisions of ASC 815, we may designate a derivative instrument as hedging the exposure to variability in expected future cash flows that are attributable to a particular risk (a "cash flow hedge") or hedging the exposure to changes in the fair value of an asset or a liability (a "fair value hedge"). Special accounting for qualifying hedges allows the effective portion of a derivative instrument's gains and losses to offset related results on the hedged item in the consolidated statements of operations and requires that a company formally document, designate and assess the effectiveness of the transactions that receive hedge accounting treatment. Both at the inception of a hedge and on an ongoing basis, a hedge must be expected to be highly effective in achieving offsetting changes in cash flows or fair value attributable to the underlying risk being hedged. If we determine that a derivative instrument is no longer highly effective as a hedge, it discontinues hedge accounting prospectively and future changes in the fair value of the derivative are recognized in current earnings. We assess hedge effectiveness at the end of each quarter.

In accordance with ASC 815, changes in the fair value of derivative instruments that are cash flow hedges are recognized in accumulated other comprehensive income (loss) and reclassified into earnings in the period in which the hedged item affects earnings. Ineffective portions of a derivative instrument's change in fair value are immediately recognized in earnings. Derivative instruments that do not qualify, or cease to qualify, as hedges must be adjusted to fair value and the adjustments are recorded through net income (loss).

The cash flows from derivative instruments receiving hedge accounting treatment are classified in the same categories as the hedged items in the consolidated statements of cash flows.

Recent Accounting Pronouncements

In August 2014, the FASB issued Accounting Standards Update No. 2014-15, "Presentation of Financial Statements – Going Concern" ("ASU 2014-15"), which provides guidance on determining when and how to disclose going-concern uncertainties in the

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financial statements. ASU 2014-15 requires management to perform interim and annual assessments of an entity's ability to continue as a going concern within one year of the date the financial statements are issued. An entity will be required to provide certain disclosures if conditions of events raise substantial doubt about the entity's ability to continue as a going concern. ASU 2014-15 is effective for annual periods ending after December 15, 2016, and interim periods thereafter, with early adoption permitted. We are currently evaluating the impact of the adoption of ASU 2014-15 on our consolidated financial statements.

In June 2014, the FASB issued Accounting Standards Update No. 2014-11, "Transfers and Servicing (Topic 860): Repurchase-to-Maturity Transactions, Repurchase Financings, and Disclosures" ("ASU 2014-11"). The guidance in this update changes the accounting for repurchase-to-maturity transactions and repurchasing financing arrangements. It also requires enhanced disclosures about repurchase agreements and other similar transactions. The accounting changes in this update are effective for public companies for the first interim or annual period beginning after December 15, 2014. In addition, for public companies, the disclosure for certain transactions accounted for as a sale is effective for the first interim or annual period beginning on or after December 15, 2014, and the disclosure for transactions accounted for as secured borrowings is required to be presented for annual periods beginning after December 15, 2014, and interim periods beginning after March 15, 2015. Early application is not permitted. We are currently evaluating the impact of the adoption of ASU 2014-11 on our consolidated financial statements.

In May 2014, the FASB issued Accounting Standards Update No. 2014-09 "Revenue from Contracts with Customers." ("ASU 2014-09"). ASU 2014-09 supersedes the revenue recognition requirements in "Revenue Recognition (Topic 605)", and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. Early adoption is not permitted. We are currently evaluating the impact of the adoption of ASU 2014-09 on our consolidated financial statements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

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

Foreign Currency Exposures

We have exposure to foreign currency exchange rate fluctuations on net income from our subsidiaries denominated in currencies other than U.S. dollars, as our foreign subsidiaries in Korea, Taiwan, China, Japan and Hong Kong use local currency as their functional currency. From time to time these subsidiaries have cash and financial instruments in local currency. The amounts held in Japan, Taiwan, Hong Kong and China are not material in regards to foreign currency movements. However, based on the cash and financial instruments balance at September 30, 2014 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 and cash balances. Based on the Japanese yen cash balance at September 30, 2014 for our Korean subsidiary, a 10% devaluation of the Japanese yen against the U.S. dollar would have resulted in a decrease of \$0.1 million in our U.S. dollar cash balance.

See “Note 8. Derivative Financial Instruments” to our consolidated financial statements under “Part I: Item 1. Interim Consolidated Financial Statements (Unaudited)” and “Part I: Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations—Factors Affecting Our Results of Operations—Impact of Foreign Currency Exchange Rates on Reported Results of Operations” of this Quarterly Report for additional information regarding our foreign exchange hedging activities.

Interest Rate Exposures

As of September 30, 2014, \$225.0 million aggregate principal amount of our 2021 Notes were outstanding. Our outstanding 2021 Notes are subject to changes in fair value due to interest rate changes. If the market interest rate increases by 10% and all other variables were held constant from their levels at September 30, 2014, we estimate that the fair value of this fixed rate note would decrease by \$7.9 million and we would have additional interest expense costs over the market rate of \$0.9 million (on a 360-day basis). If the market interest rate decreased by 10% and all other variables were held constant from their levels at September 30, 2014, we estimate that the fair value of this fixed rate note would increase by \$8.3 million and we would have a reduction in interest expense costs over the market rate of \$1.0 million (on a 360-day basis).

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Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in the reports we file or submit under the Securities Exchange Act of 1934, as amended (the “Exchange Act”), is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms, and that such information is accumulated and communicated to our management, including our Interim Chief Executive Officer and Interim Chief Financial Officer, to allow timely decisions regarding required disclosure.

In connection with the preparation of this Quarterly Report on Form 10-Q, we carried out an evaluation under the supervision of and with the participation of our management, including our Interim Chief Executive Officer and Interim Chief Financial Officer, as of September 30, 2014, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, our management, including our Interim Chief Executive Officer and Interim Chief Financial Officer, concluded that our disclosure controls and procedures were not effective as of September 30, 2014 because of the material weaknesses in internal control over financial reporting described in Part II, Item 9A of the 2013 Form 10-K. As disclosed in the 2013 Form 10-K, our management, including our Interim Chief Executive Officer and Interim Chief Financial Officer, previously concluded that our disclosure controls and procedures were not effective as of December 31, 2013 because of the material weaknesses in internal control over financial reporting described under the subheading “Management’s Annual Report on Internal Control over Financial Reporting” in Part II, Item 9A of the 2013 Form 10-K. Management has concluded that the material weaknesses that were present at December 31, 2013 were also present at September 30, 2014.

To address these material weaknesses, we performed additional analyses and other procedures (as further described under the subheading “Remediation Plan” in Part II, Item 9A of the 2013 Form 10-K) to ensure that the Company’s consolidated financial statements were prepared in accordance with US GAAP.

Previously Identified Material Weaknesses

As previously disclosed in the 2013 Form 10-K, management concluded that, based on the criteria set forth in *Internal Control - Integrated Framework (1992)* issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”), our internal control over financial reporting was not effective as of December 31, 2013 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with US GAAP. For a discussion of the material weaknesses in internal control over financial reporting, please see Part II, Item 9A of the 2013 Form 10-K.

Remediation Plan

As previously disclosed in the 2013 Form 10-K, to remediate the material weaknesses described under the subheading “Management’s Annual Report on Internal Control over Financial Reporting” in Part II, Item 9A of the 2013 Form 10-K, we have implemented or plan to implement the remediation initiatives described under the subheading “Remediation Plan” in Part II, Item 9A of the 2013 Form 10-K and will continue to evaluate the remediation and may in the future implement additional measures.

The Company’s management believes the remediation measures described in the 2013 Form 10-K will remediate the identified material weaknesses and strengthen the Company’s internal control over financial reporting. As management continues to evaluate and work to improve its internal control over financial reporting, it may be determined that additional measures must be taken to address the material weaknesses identified in Part II, Item 9A of the 2013 Form 10-K, or it may be determined that the Company needs to modify, or in appropriate circumstances not to complete, certain of the remediation measures described in the 2013 Form 10-K.

Changes in Internal Controls over Financial Reporting

There were no changes in our internal control over financial reporting during the quarter ended September 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

For a discussion of legal proceedings, see “Part I: Item 3. Legal Proceedings” of our 2013 Form 10-K.

See also “Part I: Item 1A. Risk Factors” of our 2013 Form 10-K and Notes 17 and 18 to our consolidated financial statements in this Quarterly Report for additional information.

Item 1A. Risk Factors

The Company is subject to risks and uncertainties, any of which could have a significant or material adverse effect on our business, financial condition, liquidity or consolidated financial statements. You should carefully consider the risk factors disclosed in Part I, Item 1A of our 2013 Form 10-K. The risks described herein and therein are not the only ones we face. This information should be considered carefully together with the other information contained in this report and the other reports and materials the Company files with the SEC.

There are no material changes to the Company’s risk factors disclosed in “Part I: Item 1A. Risk Factors” of our 2013 Form 10-K.

Item 3. Defaults Upon Senior Securities

As disclosed in the Company’s Form 8-K filed on June 25, 2014, the Company received a notice of default on June 20, 2014 (the “10-K and Q1 10-Q Notice of Default”) from Wilmington Trust, National Association, as trustee under the Indenture related to the 2021 Notes. The 10-K and Q1 10-Q Notice of Default related to the failure by the Company, pursuant to Section 4.03 of the Indenture, to file with the SEC its Annual Report on Form 10-K for the fiscal year ended December 31, 2013 and its Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2014 (the “Initial Reporting Defaults”). The Company did not cure the Initial Reporting Defaults within the applicable 60-day grace period and the Initial Reporting Defaults ripened into Events of Default. The Company elected, as the sole and exclusive remedy for the Events of Default, to pay additional interest on the 2021 Notes at a rate equal to 0.25% per annum of the principal amount of the 2021 Notes (the “Additional Interest”) for a period of 180 days following the occurrence of the Events of Default (the “Additional Interest Period”).

On August 20, 2014, the Company received a notice of default related to its failure to file its Form 10-Q for the fiscal quarter ended June 30, 2014 (the “Q2 10-Q Notice of Default”), and on November 19, 2014, the Company received a notice of default related to its failure to file its Form 10-Q for the fiscal quarter ended September 30, 2014 (the “Q3 10-Q Notice of Default”). These defaults also ripened into Events of Default and on December 29, 2014 and January 15, 2015, respectively, the Company elected to extend the Additional Interest Period for up to 180 days following each additional Event of Default.

Upon the filing with the SEC of the 2013 Form 10-K, the Form 10-Qs for each of the fiscal quarters ended March 31, 2014 and June 30, 2014, and this Report, the Company believes it has regained compliance with its reporting obligations under the Indenture and cured all identified covenant defaults in each of the 10-K and Q1 10-Q Notice of Default, the Q2 10-Q Notice of Default, and the Q3 10-Q Notice of Default, and has ceased accruing the Additional Interest on the 2021 Notes as of the filing date of this Report.

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Item 6. Exhibits.

<u>Exhibit Number</u>	<u>Description</u>
10.27*	Employment Separation Agreement, effective July 31, 2014, by and between MagnaChip Semiconductor, Ltd. (Korea) and Sang Park (incorporated by reference to Exhibit 10.27 to our Annual Report on Form 10-K filed on February 12, 2015).
31.1#	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Executive Officer.
31.2#	Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Financial Officer.
32.1†	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer.
32.2†	Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer.
101.INS#	XBRL Instance Document.
101.SCH#	XBRL Taxonomy Extension Schema Document.
101.CAL#	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF#	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB#	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE#	XBRL Taxonomy Extension Presentation Linkbase Document.

Footnotes:

- * Management contract, compensatory plan or arrangement
- # Filed herewith
- † Furnished herewith

SIGNATURES

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

MAGNACHIP SEMICONDUCTOR CORPORATION
(Registrant)

Dated: February 12, 2015

By: /s/ Young-Joon Kim

Young-Joon Kim
Interim Chief Executive Officer
(Authorized Officer)

Dated: February 12, 2015

By: /s/ Jonathan W. Kim

Jonathan W. Kim
Interim Chief Financial Officer, Senior Vice President and Chief
Accounting Officer
(Principal Financial and Accounting Officer)

INDEX TO EXHIBITS

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Footnotes:

- * Management contract, compensatory plan or arrangement
- # Filed herewith
- † Furnished herewith

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

I, Young-Joon Kim, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MagnaChip Semiconductor Corporation for the quarter ended September 30, 2014;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 12, 2015

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

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

I, Jonathan W. Kim, certify that:

1. I have reviewed this quarterly report on Form 10-Q of MagnaChip Semiconductor Corporation for the quarter ended September 30, 2014;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Dated: February 12, 2015

/s/ Jonathan W. Kim

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

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

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

(i) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the “**Report**”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

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

Dated: February 12, 2015

/s/ Young-Joon Kim

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

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

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

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

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

(i) the Quarterly Report on Form 10-Q of the Company for the quarterly period ended September 30, 2014 as filed with the Securities and Exchange Commission on the date hereof (the “**Report**”) fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934, as amended; and

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

Dated: February 12, 2015

/s/ Jonathan W. Kim

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

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

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

