

MAGNACHIP SEMICONDUCTOR Corp  
Form 10-Q  
August 05, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended June 30, 2016**

**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** **83-0406195**  
**(State or other jurisdiction of** **(I.R.S. Employer**  
**incorporation or organization)** **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

As of July 31, 2016, the registrant had 34,731,754 shares of common stock outstanding.

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**MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES**

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**Table of Contents****PART I FINANCIAL INFORMATION****Item 1. Interim Consolidated Financial Statements (Unaudited)****MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS (Unaudited)**

|  | <b>June 30,<br/>2016</b>                                   | <b>December 31,<br/>2015</b> |
|--|--|------------------------------|
|  | <b>(In thousands of US dollars,<br/>except share data)</b> |                              |
| <b>Assets</b>                              |  |                              |
| Current assets                             |  |                              |
| Cash and cash equivalents                  | \$ 83,914  | \$ 90,882                    |
| Restricted cash (Note 17)                  | 29,600   |                              |
| Accounts receivable, net                   | 54,702   | 63,498                       |
| Inventories, net                           | 70,439   | 57,619                       |
| Other receivables (Note 17)                | 6,025  | 31,932                       |
| Prepaid expenses                           | 10,241   | 7,075                        |
| Hedge collateral                           |  | 6,000                        |
| Other current assets                       | 2,942  | 3,228                        |
| <b>Total current assets</b>                | <b>257,863</b>   | <b>260,234</b>               |
| Property, plant and equipment, net         | 184,665  | 191,985                      |
| Intangible assets, net                     | 2,897  | 2,629                        |
| Long-term prepaid expenses                 | 13,421   | 12,117                       |
| Deferred income tax assets                 | 245  | 238                          |
| Other non-current assets                   | 6,570  | 6,897                        |
| <b>Total assets</b>                        | <b>\$ 465,661</b>  | <b>\$ 474,100</b>            |
| <b>Liabilities and Stockholders Equity</b> |  |                              |
| Current liabilities                        |  |                              |
| Accounts payable                           | \$ 64,243  | \$ 55,476                    |
| Other accounts payable                     | 8,836  | 10,961                       |
| Accrued expenses                           | 80,062   | 76,721                       |
| Deferred revenue                           | 11,310   | 10,060                       |
| Deposits received                          |  | 8,165                        |
| Other current liabilities                  | 4,741  | 5,128                        |
| <b>Total current liabilities</b>           | <b>169,192</b>   | <b>166,511</b>               |
| Long-term borrowings, net                  | 220,722  | 220,375                      |

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|  |            |            |
|--|------------|------------|
| Accrued severance benefits, net  | 131,841    | 134,148    |
| Other non-current liabilities  | 14,235     | 15,396     |
| Total liabilities  | 535,990    | 536,430    |
| Commitments and Contingencies (Note 17)  |            |            |
| Stockholders' equity   |            |            |
| Common stock, \$0.01 par value, 150,000,000 shares authorized, 41,310,519 shares issued and 34,731,754 outstanding at June 30, 2016 and 41,147,707 shares issued and 34,568,942 outstanding at December 31, 2015 | 412        | 411        |
| Additional paid-in capital   | 126,121    | 124,618    |
| Accumulated deficit  | (105,901)  | (96,210)   |
| Treasury stock, 6,578,765 shares at June 30, 2016 and December 31, 2015  | (90,918)   | (90,918)   |
| Accumulated other comprehensive loss   | (43)       | (231)      |
| Total stockholders' deficit  | (70,329)   | (62,330)   |
| Total liabilities and stockholders' equity   | \$ 465,661 | \$ 474,100 |

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

Table of Contents**MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS (Unaudited)**

|  | <b>Three Months Ended</b>                              |                 | <b>Six Months Ended</b> |                 |
|--|--|-----------------|-------------------------|-----------------|
|  | <b>June 30,</b>  | <b>June 30,</b> | <b>June 30,</b>         | <b>June 30,</b> |
|  | <b>2016</b>  | <b>2015</b>     | <b>2016</b>             | <b>2015</b>     |
|  | <b>(In thousands of US dollars, except share data)</b> |                 |                         |                 |
| Net sales                                    | \$ 167,106   | \$ 162,015      | \$ 315,211              | \$ 326,900      |
| Cost of sales                                | 130,357  | 126,729         | 244,213                 | 256,637         |
| Gross profit                                 | 36,749   | 35,286          | 70,998                  | 70,263          |
| Operating expenses                           |  |                 |                         |                 |
| Selling, general and administrative expenses | 25,948   | 28,588          | 45,900                  | 53,618          |
| Research and development expenses            | 18,178   | 21,931          | 35,993                  | 44,091          |
| Restructuring gain                           |  |                 | (7,785)                 |                 |
| Total operating expenses                     | 44,126   | 50,519          | 74,108                  | 97,709          |
| Operating loss                               | (7,377)  | (15,233)        | (3,110)                 | (27,446)        |
| Interest expense                             | (4,073)  | (3,987)         | (8,130)                 | (8,112)         |
| Foreign currency gain (loss), net            | (7,101)  | (12,296)        | 1,094                   | (15,472)        |
| Other income, net                            | 1,007  | 288             | 1,542                   | 906             |
| Loss before income taxes                     | (17,544)   | (31,228)        | (8,604)                 | (50,124)        |
| Income tax expenses (benefits)               | 272  | (602)           | 1,087                   | 531             |
| Net loss                                     | \$ (17,816)  | \$ (30,626)     | \$ (9,691)              | \$ (50,655)     |
| Loss per common share                        |  |                 |                         |                 |
| Basic  | \$ (0.51)  | \$ (0.90)       | \$ (0.28)               | \$ (1.49)       |
| Diluted                                      | \$ (0.51)  | \$ (0.90)       | \$ (0.28)               | \$ (1.49)       |
| Weighted average number of shares            |  |                 |                         |                 |
| Basic  | 34,716,081   | 34,092,402      | 34,707,492              | 34,074,534      |
| Diluted                                      | 34,716,081   | 34,092,402      | 34,707,492              | 34,074,534      |

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

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

|  | <b>Three Months Ended</b>           |                    | <b>Six Months Ended</b> |                    |
|--|-------------------------------------|--------------------|-------------------------|--------------------|
|  | <b>June 30,</b>                     | <b>June 30,</b>    | <b>June 30,</b>         | <b>June 30,</b>    |
|  | <b>2016</b>                         | <b>2015</b>        | <b>2016</b>             | <b>2015</b>        |
|  | <b>(In thousands of US dollars)</b> |                    |                         |                    |
| Net loss   | \$ (17,816)                         | \$ (30,626)        | \$ (9,691)              | \$ (50,655)        |
| Other comprehensive income   |                                     |                    |                         |                    |
| Foreign currency translation adjustments                                 | 6,167                               | 10,123             | 147                     | 13,179             |
| Derivative adjustments   |                                     |                    |                         |                    |
| Fair valuation of derivatives  | (24)                                | (1,417)            | 41                      | (1,417)            |
| Reclassification adjustment for gain on derivatives included in net loss |                                     |                    |                         | (485)              |
| <b>Total other comprehensive income</b>                                  | <b>6,143</b>                        | <b>8,706</b>       | <b>188</b>              | <b>11,277</b>      |
| <b>Total comprehensive loss</b>  | <b>\$ (11,673)</b>                  | <b>\$ (21,920)</b> | <b>\$ (9,503)</b>       | <b>\$ (39,378)</b> |

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

Table of Contents**MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS EQUITY (Unaudited)**

| (In thousands of US dollars, except share data) | Common Stock      |               | Additional        | Accumulated         | Treasur            | Accumulated              | Total              |
|---|-------------------|---------------|-------------------|---------------------|--------------------|--------------------------|--------------------|
|   | Shares            | Amount        | Paid-In Capital   | Deficit             | Stock              | Other Comprehensive Loss |                    |
| <b>Six Months Ended June 30, 2016</b>           |                   |               |                   |                     |                    |                          |                    |
| Balance at January 1, 2016                      | 34,568,942        | \$ 411        | \$ 124,618        | \$ (96,210)         | \$ (90,918)        | \$ (231)                 | \$ (62,330)        |
| Stock-based compensation                        |                   |               | 1,504             |                     |                    |                          | 1,504              |
| Settlement of restricted stock units            | 162,812           | 1             | (1)               |                     |                    |                          |                    |
| Other comprehensive income, net                 |                   |               |                   |                     |                    | 188                      | 188                |
| Net loss  |                   |               |                   | (9,691)             |                    |                          | (9,691)            |
| <b>Balance at June 30, 2016</b>                 | <b>34,731,754</b> | <b>\$ 412</b> | <b>\$ 126,121</b> | <b>\$ (105,901)</b> | <b>\$ (90,918)</b> | <b>\$ (43)</b>           | <b>\$ (70,329)</b> |
| <b>Six Months Ended June 30, 2015</b>           |                   |               |                   |                     |                    |                          |                    |
| Balance at January 1, 2015                      | 34,056,468        | \$ 406        | \$ 118,419        | \$ (11,343)         | \$ (90,918)        | \$ (35,066)              | \$ (18,502)        |
| Stock-based compensation                        |                   |               | 1,977             |                     |                    |                          | 1,977              |
| Exercise of stock options                       | 205,452           | 2             | 1,206             |                     |                    |                          | 1,208              |
| Other comprehensive income, net                 |                   |               |                   |                     |                    | 11,277                   | 11,277             |
| Net loss  |                   |               |                   | (50,655)            |                    |                          | (50,655)           |
| <b>Balance at June 30, 2015</b>                 | <b>34,261,920</b> | <b>\$ 408</b> | <b>\$ 121,602</b> | <b>\$ (61,998)</b>  | <b>\$ (90,918)</b> | <b>\$ (23,789)</b>       | <b>\$ (54,695)</b> |

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



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|  | <b>Six Months Ended</b>             |                          |
|--|-------------------------------------|--------------------------|
|  | <b>June 30,<br/>2016</b>            | <b>June 30,<br/>2015</b> |
|  | <b>(In thousands of US dollars)</b> |                          |
| <b>Cash flows from operating activities</b>                                |                                     |                          |
| Net loss   | \$ (9,691)                          | \$ (50,655)              |
| Adjustments to reconcile net loss to net cash used in operating activities |                                     |                          |
| Depreciation and amortization  | 12,252                              | 13,667                   |
| Provision for severance benefits   | 9,827                               | 11,877                   |
| Amortization of debt issuance costs and original issue discount            | 347                                 | 324                      |
| Loss (gain) on foreign currency, net                                       | (1,140)                             | 17,146                   |
| Restructuring gain   | (7,785)                             |                          |
| Stock-based compensation   | 1,504                               | 1,977                    |
| Other  | 164                                 | 1,544                    |
| Changes in operating assets and liabilities                                |                                     |                          |
| Accounts receivable, net   | 8,505                               | 3,145                    |
| Inventories, net   | (11,946)                            | 1,623                    |
| Other receivables  | (3,635)                             | 5,523                    |
| Other current assets   | 2,123                               | 2,235                    |
| Deferred tax assets  | 37                                  | 339                      |
| Accounts payable   | 7,779                               | (12,431)                 |
| Other accounts payable   | (5,156)                             | (5,550)                  |
| Accrued expenses   | 1,913                               | (10,710)                 |
| Other current liabilities  | (1,364)                             | (699)                    |
| Deferred revenue   | 1,477                               | (1,359)                  |
| Other non-current liabilities  | (661)                               | (1,084)                  |
| Payment of severance benefits  | (13,102)                            | (4,231)                  |
| Other  | (137)                               | (147)                    |
| Net cash used in operating activities                                      | (8,689)                             | (27,466)                 |
| <b>Cash flows from investing activities</b>                                |                                     |                          |
| Proceeds from settlement of hedge collateral                               | 5,917                               |                          |
| Payment of hedge collateral  |                                     | (6,555)                  |
| Purchase of plant, property and equipment                                  | (5,834)                             | (1,964)                  |
| Payment for intellectual property registration                             | (478)                               | (263)                    |
| Collection of guarantee deposits   | 383                                 |                          |
| Payment of guarantee deposits  | (11)                                | (642)                    |
| Other  | 11                                  | 237                      |
| Net cash used in investing activities                                      | (12)                                | (9,187)                  |

| <b>Cash flows from financing activities</b>   |             |    |          |
|---|-------------|----|----------|
| Proceeds from issuance of common stock  |             |    | 1,208    |
| Net cash provided by financing activities   |             |    | 1,208    |
| Effect of exchange rates on cash and cash equivalents                               | 1,733       |    | 5,683    |
| Net decrease in cash and cash equivalents   | (6,968)     |    | (29,762) |
| <b>Cash and cash equivalents</b>  |             |    |          |
| Beginning of the period   | 90,882      |    | 102,434  |
| End of the period   | \$ 83,914   | \$ | 72,672   |
| <b>Supplemental cash flow information</b>   |             |    |          |
| Cash paid for interest  | \$ 7,453    | \$ | 7,683    |
| Cash paid for income taxes  | \$ 469      | \$ | 388      |
| <b>Non-cash operating activities</b>  |             |    |          |
| Insurance proceeds in restricted cash reclassified from other receivables (Note 17) | \$ (29,571) | \$ |          |
| <b>Non-cash investing activities</b>  |             |    |          |
| Property, plant and equipment additions in other accounts payable                   | \$ 993      | \$ | 1,493    |

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

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**MAGNACHIP SEMICONDUCTOR CORPORATION AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(TABULAR DOLLARS IN THOUSANDS, EXCEPT SHARE DATA)**

**1. Business, Basis of Presentation and Significant Accounting Policies**

***Business***

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

***Basis of Presentation***

The accompanying unaudited interim consolidated financial statements of the Company have been prepared in accordance with generally accepted accounting principles in the United States of America (US GAAP). These interim consolidated financial statements include normal recurring adjustments and the elimination of all intercompany accounts and transactions which are, in the opinion of management, necessary to provide a fair statement of the Company's financial condition and results of operations for the periods presented. These interim consolidated financial statements are presented in accordance with Accounting Standards Codification 270, *Interim Reporting* and, accordingly, do not include all of the information and note disclosures required by US GAAP for complete financial statements. The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the results to be expected for a full year or for any other periods.

The December 31, 2015 balance sheet data was derived from the Company's audited financial statements, but does not include all disclosures required by US GAAP.

***Significant Accounting Policies***

For a description of significant accounting policies, see Note 1, Business, Basis of Presentation and Summary of Significant Accounting Policies, of the Notes to the Consolidated Financial Statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2015. A significant accounting policy adopted in fiscal 2016 is disclosed below.

***Vendor Rebates*** The Company, from time to time, enters into arrangements whereby rebates are obtained from vendors when the Company achieves certain levels of purchases. The vendor rebates are computed at an agreed upon

amount or percentage of purchase levels. As these vendor rebates are impacted by actual and estimated purchases for the applicable agreed upon period, the Company periodically assesses the progress of its purchase levels and revises the estimates when necessary. The Company accounts for such rebates as a reduction of inventory until it sells the product, at which time such rebates are reflected as a reduction of cost of sales in its consolidated statements of operations. Vendor rebates recorded as a reduction of inventory were \$0.2 million as of June 30, 2016 and as a reduction of cost of sales were \$1.2 million for the six months ended June 30, 2016.

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### ***Recent Accounting Pronouncements***

In March 2016, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update No. 2016-09, Improvements to Employee Share-Based Payment Accounting ( ASU 2016-09 ). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. ASU 2016-09 is effective for fiscal years beginning after December 15, 2016, and interim periods within those years and early adoption is permitted. The Company is currently evaluating the impact of adoption of ASU 2016-09 on its consolidated financial statements.

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

In November 2015, the FASB issued Accounting Standards Update No. 2015-17, Income Taxes (Topic 740): Balance Sheet Classification of Deferred Taxes ( ASU 2015-17 ). The amendments in ASU 2015-17 require an entity to classify all deferred tax assets and liabilities as noncurrent. ASU 2015-17 is effective for fiscal years beginning after December 15, 2016 and interim periods within those years and early adoption is permitted. The Company does not expect the adoption of ASU 2015-17 to have a material effect on the Company's consolidated financial statements.

In July 2015, the FASB issued Accounting Standards Update No. 2015-11, Simplifying the Measurement of Inventory ( ASU 2015-11 ). Under this ASU, inventory will be measured at the lower of cost and net realizable value, and options that currently exist for market value will be eliminated. Net realizable value is defined as the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. No other changes were made to the current guidance on inventory measurement. ASU 2015-11 is effective for interim and annual periods beginning after December 15, 2016, with early adoption permitted. The Company does not expect the adoption of ASU 2015-11 to have a material effect on the Company's consolidated financial statements.

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 May 2014, the FASB issued Accounting Standards Update No. 2014-09, Revenue from Contracts with Customers (Topic 606) ( ASU 2014-09 ). ASU 2014-09 supersedes the revenue recognition requirements in Revenue Recognition (Topic 605) , and requires entities to recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016 (the Original Effective Date ) , including interim periods within that reporting period, and can be adopted either retrospectively to

each prior period presented or as a cumulative-effect adjustment as of the date of adoption, with early application permitted as of the Original Effective Date. In August 2015, the FASB issued ASU 2015-14 Deferral of the Effective Date, which defers the required adoption date of ASU 2014-09 by one year. As a result of the deferred effective date, ASU 2014-09 will be effective for annual reporting periods beginning after December 15, 2017, including interim periods within that reporting period. Early adoption is permitted but not before the original effective date as of annual reporting periods beginning after December 15, 2016, including interim periods within that reporting period. In March 2016, the FASB issued Accounting Standards Update No. 2016-08, Revenue from Contracts with Customers (Topic 606), Principal versus Agent Considerations (Reporting Revenue Gross versus Net) (ASU 2016-08) clarifying the implementation guidance on principal versus agent considerations. Specifically, an entity is required to determine whether the nature of a promise is to provide the specified good or service itself (that is, the entity is a principal) or to arrange for the good or service to be provided to the customer by the other party (that is, the entity is an agent). The determination influences the timing and amount of revenue recognition. In May 2016, the FASB issued Accounting Standards Update No. 2016-12, Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients (ASU 2016-12) clarifying how to assess collectibility, present sales tax, treat noncash consideration, and account for completed and modified contracts at the time of transition. In addition, ASU 2016-12 clarifies that an entity retrospectively applying the guidance in Topic 606 is not required to disclose the effect of the accounting change in the period of adoption. The effective date and transition requirements for ASU 2016-12, ASU 2016-08 and ASU 2014-09 are the same. The Company is currently evaluating the potential impact of adopting ASU 2014-09, ASU 2016-08 and ASU 2016-12 on its consolidated financial statements.

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***Recently Adopted Accounting Pronouncement***

In April 2015, the FASB issued Accounting Standards Update No. 2015-03, Interest Imputation of Interest ( ASU 2015-03 ). ASU 2015-03 requires that debt issuance costs are presented in the balance sheet as a direct deduction from the carrying amount of debt liability, consistent with debt discounts or premiums. The recognition and measurement guidance for debt issuance costs would not be affected. Prior to the issuance of ASU 2015-03, debt issuance costs were required to be presented as an asset in the balance sheet. The Company adopted ASU 2015-03 in the first quarter of fiscal 2016 and reclassified all prior periods presented in its consolidated balance sheets to conform to the current period presentation. As of June 30, 2016 and December 31, 2015, \$3,497 thousand and \$3,781 thousand, respectively, of debt issuance costs were reclassified in the consolidated balance sheets from other non-current assets to a reduction of long-term borrowings. The adoption of ASU 2015-03 did not impact the Company's consolidated statements of operations and cash flows.

**Table of Contents****2. Sales of Accounts Receivable and Receivable Discount Program**

The Company has entered into an agreement to sell selected trade accounts receivable to a financial institution from time to time since March 2012. After the sale, the Company does not retain any interest in the receivables and the applicable financial institution collects these accounts receivable directly from the customer. The proceeds from the sales of these accounts receivable totaled \$10,973 thousand and \$32,143 thousand for the six months ended June 30, 2016 and 2015, respectively, and these sales resulted in pre-tax losses of \$36 thousand and \$37 thousand for the six months ended June 30, 2016 and 2015, respectively, which are included in selling, general and administrative expenses in the consolidated statements of operations. Net proceeds of this accounts receivable sale program are recognized in the consolidated statements of cash flows as part of operating cash flows.

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

**3. Inventories**

Inventories as of June 30, 2016 and December 31, 2015 consist of the following:

|   | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|--------------------------|------------------------------|
| Finished goods                          | \$ 21,528                | 18,427                       |
| Semi-finished goods and work-in-process | 55,396                   | 47,131                       |
| Raw materials                           | 6,692                    | 5,987                        |
| Materials in-transit                    | 1,820                    | 2,107                        |
| Less: inventory reserve                 | (14,997)                 | (16,033)                     |
| Inventories, net                        | \$ 70,439                | \$ 57,619                    |

|                         | <b>Three Months<br/>Ended<br/>June 30, 2016</b> | <b>Six Months<br/>Ended</b> | <b>Three Months<br/>Ended<br/>June 30, 2015</b> | <b>Six Months<br/>Ended</b> |
|-------------------------|---|-----------------------------|---|-----------------------------|
| Beginning balance       | \$ (17,246)                                     | \$ (16,033)                 | \$ (41,818)                                     | \$ (47,488)                 |
| Change in reserve       | 547   | (1,181)                     | (4,977)   | (5,864)                     |
| Write off               | 1,526   | 2,297                       | 14,912  | 21,240                      |
| Translation adjustments | 176   | (80)                        | 522   | 751                         |
| Ending balance          | \$ (14,997)                                     | \$ (14,997)                 | \$ (31,361)                                     | \$ (31,361)                 |

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.





**Table of Contents****4. Property, Plant and Equipment**

Property, plant and equipment as of June 30, 2016 and December 31, 2015 are comprised of the following:

|   | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|--------------------------|------------------------------|
| Buildings and related structures          | \$ 67,023                | \$ 66,487                    |
| Machinery and equipment                   | 254,522                  | 256,259                      |
| Vehicles and others                       | 28,875                   | 27,075                       |
|   | 350,420                  | 349,821                      |
| Less: accumulated depreciation            | (180,557)                | (172,546)                    |
| Land                                      | 14,802                   | 14,710                       |
| <b>Property, plant and equipment, net</b> | <b>\$ 184,665</b>        | <b>\$ 191,985</b>            |

Aggregate depreciation expenses totaled \$12,036 thousand and \$13,502 thousand for the six months ended June 30, 2016 and 2015, respectively.

**5. Intangible Assets**

Intangible assets as of June 30, 2016 and December 31, 2015 are comprised of the following:

|                               | <b>June 30, 2016</b>     |                                     |                       |
|-------------------------------|--------------------------|-------------------------------------|-----------------------|
|                               | <b>Gross<br/>amount</b>  | <b>Accumulated<br/>amortization</b> | <b>Net<br/>amount</b> |
| Technology                    | \$ 18,576                | \$ (18,576)                         | \$                    |
| Customer relationships        | 26,679                   | (26,679)                            |                       |
| Intellectual property assets  | 8,814                    | (5,917)                             | 2,897                 |
| <b>Intangible assets, net</b> | <b>\$ 54,069</b>         | <b>\$ (51,172)</b>                  | <b>\$ 2,897</b>       |
|                               | <b>December 31, 2015</b> |                                     |                       |
|                               | <b>Gross<br/>amount</b>  | <b>Accumulated<br/>amortization</b> | <b>Net<br/>amount</b> |
| Technology                    | \$ 18,460                | \$ (18,460)                         | \$                    |
| Customer relationships        | 26,513                   | (26,513)                            |                       |
| Intellectual property assets  | 8,357                    | (5,728)                             | 2,629                 |
| <b>Intangible assets, net</b> | <b>\$ 53,330</b>         | <b>\$ (50,701)</b>                  | <b>\$ 2,629</b>       |

Aggregate amortization expenses for intangible assets totaled \$216 thousand and \$165 thousand for the six months ended June 30, 2016 and 2015, respectively.

**6. Accrued Expenses**

Accrued expenses as of June 30, 2016 and December 31, 2015 are comprised of the following:

|   | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|---|--------------------------|------------------------------|
| Payroll, benefits and related taxes, excluding severance benefits | \$ 24,735                | \$ 18,831                    |
| Withholding tax attributable to intercompany interest income      | 14,005                   | 13,130                       |
| Interest on senior notes  | 6,831                    | 6,831                        |
| Settlement obligations  | 421                      | 1,012                        |
| Accrued claim settlement  | 23,500                   | 23,500                       |
| Outside service fees  | 3,487                    | 4,327                        |
| Others  | 7,083                    | 9,090                        |
| Accrued expenses  | \$ 80,062                | \$ 76,721                    |

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Accrued claim settlement included in the table above relates to the Company's securities class action complaints. On December 10, 2015, it was determined that the Company is obligated to make an aggregate settlement payment of \$23,500 thousand, which includes all attorneys' fees, costs of administration and plaintiffs' out-of-pocket expenses, lead plaintiff compensatory awards and disbursements. In connection with the securities class action complaints, the Company also settled with its insurers and obtained proceeds of \$29.6 million, which are recorded as restricted cash as of June 30, 2016. For more information on the accrued claim settlement, see Note 17. Commitments and Contingencies.

Payroll, benefits and related taxes in the table above includes unpaid other termination benefits under the voluntary resignation program of \$3.5 million payable as of June 30, 2016, out of the \$4.2 million total aggregate expense for such benefits during the quarter ended June 30, 2016, which are payable in equal monthly installments over the twelve month period which began in May 2016.

**7. Derivative Financial Instruments**

The Company's Korean subsidiary from time to time has entered into 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.

The Company did not have any derivative contracts in effect as of June 30, 2016.

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

The fair values of the Company's outstanding zero cost collar contracts recorded as liabilities as of June 30, 2016 and December 31, 2015 are as follows:

| <b>Derivatives designated as hedging instruments:</b> | <b>June 30,</b> | <b>December 31,</b> |
|---|-----------------|---------------------|
|   | <b>2016</b>     | <b>2015</b>         |
| <b>Liabilities Derivatives:</b>                       |                 |                     |
| Zero cost collars                                     | \$              | \$ 40               |

Offsetting of derivative liabilities as of December 31, 2015 is as follows:

| <b>As of December 31, 2015</b>  | <b>Gross amounts of</b> | <b>Gross amounts of</b> | <b>Net amounts of</b>   | <b>Gross amounts not offset</b> | <b>in the balance</b> | <b>Cash collateral</b> | <b>Net amount</b> |
|---------------------------------|-------------------------|-------------------------|-------------------------|---------------------------------|-----------------------|------------------------|-------------------|
|                                 | <b>recognized</b>       | <b>in the</b>           | <b>presented in the</b> | <b>in the balance</b>           | <b>received/</b>      | <b>pledged</b>         |                   |
|                                 | <b>liabilities</b>      | <b>balance</b>          | <b>balance</b>          | <b>Financial</b>                | <b>pledged</b>        | <b>pledged</b>         |                   |
|                                 | <b>liabilities</b>      | <b>sheets</b>           | <b>sheets</b>           | <b>instruments</b>              | <b>pledged</b>        | <b>pledged</b>         | <b>Net amount</b> |
| <b>Liabilities Derivatives:</b> |                         |                         |                         |                                 |                       |                        |                   |
| Zero cost collars               | \$ 40                   | \$                      | \$ 40                   | \$                              | \$                    | \$                     | \$ 40             |

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.

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The following table summarizes the impact of derivative instruments on the consolidated statement of operations for the three months ended June 30, 2016 and 2015:

| Derivatives in ASC                  | Amount of Loss Recognized in AOCI on Derivatives (Effective Portion) |            | Location of Gain                          | Amount of Gain Reclassified from AOCI into Operations (Effective Portion) |      | Location of Loss  | Amount of Loss Recognized in Statement of Operations on Derivatives (Ineffective Portion) |          |
|-------------------------------------|--|------------|---|---|------|---|---|----------|
|                                     | Three Months Ended June 30,  |            | Reclassified from Statement of Operations | Three Months Ended June 30,   |      | Recognized in Statement of Operations on Derivative (Ineffective Portion) | Three Months Ended June 30,   |          |
| 815 Cash Flow Hedging Relationships | 2016   | 2015       |   | 2016  | 2015 |   | 2016  | 2015     |
| Zero cost collars                   | \$ (24)  | \$ (1,417) | Net sales                                 | \$  | \$   | Other income, net   | \$ (8)  | \$ (306) |
| Total                               | \$ (24)  | \$ (1,417) |   | \$  | \$   |   | \$ (8)  | \$ (306) |

The following table summarizes the impact of derivative instruments on the consolidated statement of operations for the six months ended June 30, 2016 and 2015:

| Derivatives in ASC                  | Amount of Gain (Loss) Recognized in AOCI on Derivatives (Effective Portion) |            | Location of Gain                          | Amount of Gain Reclassified from AOCI into Operations (Effective Portion) |        | Location of Gain (Loss)   | Amount of Gain (Loss) Recognized in Statement of Operations on Derivatives (Ineffective Portion) |          |
|-------------------------------------|---|------------|---|---|--------|---|--|----------|
|                                     | Six Months Ended June 30,   |            | Reclassified from Statement of Operations | Six Months Ended June 30,   |        | Recognized in Statement of Operations on Derivative (Ineffective Portion) | Six Months Ended June 30,  |          |
| 815 Cash Flow Hedging Relationships | 2016  | 2015       |   | 2016  | 2015   |   | 2016   | 2015     |
| Zero cost collars                   | \$ 41   | \$ (1,417) | Net sales                                 | \$  | \$ 485 | Other income, net   | \$ 34  | \$ (306) |
| Total                               | \$ 41   | \$ (1,417) |   | \$  | \$ 485 |   | \$ 34  | \$ (306) |

The Company had set aside \$6,000 thousand cash deposits to the counterparty, Nomura Financial Investment (Korea) Co., Ltd. ( NFIK ) for the zero cost collar contracts outstanding as of December 31, 2015, and has received all of such cash deposits back from NFIK as of June 30, 2016 as the contracts have expired.

**Table of Contents****8. Fair Value Measurements**

As of June 30, 2016, the Company did not have any financial assets or liabilities measured at fair value on a recurring basis. As of December 31, 2015, the carrying value of derivative liabilities, which are measured at fair value on a recurring basis, was \$40 thousand. Its fair value measurement was based on Level 2 inputs.

As of June 30, 2016, the Company did not have any assets or liabilities measured at fair value on a recurring basis other than cash and cash equivalents and restricted cash, fair value of which approximate carrying values due to the short-term nature of these instruments. The fair value of assets and liabilities whose carrying value approximates fair value is determined using Level 2 inputs, with the exception of cash (Level 1).

As of June 30, 2016, the total carrying value and estimated fair value of the Company's 6.625% Senior Notes due July 15, 2021 (the 2021 Notes), which are not measured at fair value on a recurring basis, were \$220,722 thousand and \$173,266 thousand, respectively. As of December 31, 2015, the total carrying value and estimated fair value of the 2021 Notes were \$220,375 thousand and \$157,500 thousand, respectively. The estimated fair values are based on Level 2 inputs.

**9. Long-Term Borrowings**

Long-term borrowings as of June 30, 2016 and December 31, 2015 are as follows:

|  | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|--------------------------|------------------------------|
| 6.625% senior notes due July 2021  | \$ 225,000               | \$ 225,000                   |
| Less: unamortized discount and debt issuance costs                               | (4,278)                  | (4,625)                      |
| <b>Long-term borrowings, net of unamortized discount and debt issuance costs</b> | <b>\$ 220,722</b>        | <b>\$ 220,375</b>            |

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

The Company can optionally redeem all or a part of the 2021 Notes according to the following schedule: (i) 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 issued under that certain Indenture, dated as of July 18, 2013, by and between the Company and Wilmington Trust, National Association, as trustee (the Trustee), as supplemented by that certain First Supplemental Indenture, dated as of March 27, 2014 (collectively, the Indenture), related to 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 (ii) on or after July 15, 2017, the Company may on any one or more occasions redeem all or a part of the 2021 Notes, at a redemption price equal to 103.313%, 101.656% and 100% of the principal amount of the notes redeemed on or after July 15, 2017, 2018 and 2019, respectively, plus accrued and unpaid interest and special interest, if any, on the notes redeemed, to the applicable date of redemption.

The Indenture relating to the 2021 Notes contains covenants that limit ability of the Company and its restricted subsidiaries to: (i) declare or pay any dividend or make any payment or distribution on account of or purchase or

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

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



**Table of Contents****10. Accrued Severance Benefits**

The majority of accrued severance benefits are for employees in the Company's Korean subsidiary. Pursuant to the Employee Retirement Benefit Security Act of Korea, eligible employees and executive officers with one or more years of service are entitled to severance benefits upon the termination of their employment based on their length of service and rate of pay. As of June 30, 2016, 98% of employees of the Company were eligible for severance benefits.

Changes in accrued severance benefits are as follows:

|   | <b>Three<br/>Months<br/>Ended<br/>June 30, 2016</b> | <b>Six<br/>Months<br/>Ended</b> | <b>Three<br/>Months<br/>Ended<br/>June 30, 2015</b> | <b>Six<br/>Months<br/>Ended</b> |
|---|---|---------------------------------|---|---------------------------------|
| Beginning balance   | \$ 139,103  | \$ 135,160                      | \$ 145,598  | \$ 140,405                      |
| Provisions  | 4,056   | 9,827                           | 4,617   | 11,877                          |
| Severance payments  | (9,004)   | (13,102)                        | (2,890)   | (4,231)                         |
| Translation adjustments                                     | (1,355)   | 915                             | (2,525)   | (3,251)                         |
|   | 132,800   | 132,800                         | 144,800   | 144,800                         |
| Less: Cumulative contributions to the National Pension Fund | (290)   | (290)                           | (333)   | (333)                           |
| Group severance insurance plan                              | (669)   | (669)                           | (740)   | (740)                           |
| Accrued severance benefits, net                             | \$ 131,841  | \$ 131,841                      | \$ 143,727  | \$ 143,727                      |

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:

|                   | <b>Severance benefit</b> |
|-------------------|--------------------------|
| Remainder of 2016 | \$                       |
| 2017              |                          |
| 2018              |                          |
| 2019              | 935                      |
| 2020              | 1,672                    |
| 2021              | 2,652                    |
| 2022 - 2026       | 20,028                   |

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.

The above table reflects an effect of a mandatory extension of retirement age in Korea from 57 to 60 under the Employment Promotion for the Aged Act effective from the beginning of 2016.

### **11. 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 the Company's Korean subsidiary. The loans are denominated in U.S. dollars and are affected by changes in the exchange rate between the Korean won and the U.S. dollar. As of June 30, 2016, the outstanding intercompany loan balance including accrued interests between the Korean subsidiary and the Dutch subsidiary was \$594 million. The Korean won to U.S. dollar exchange rates were 1,164.7:1 and 1,172.0:1 using the first base rate as of June 30, 2016 and December 31, 2015, respectively, as quoted by the KEB Hana Bank (formerly Korea Exchange Bank).

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**12. Restructuring Gain**

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

**13. Income Taxes**

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

The Company's Korean subsidiary is the principal operating entity within the consolidated Company. For the six months ended June 30, 2016 and 2015, no income tax expense or benefit for the Korean subsidiary was recorded due to net loss, net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets.

Income tax expense recorded for the six months ended June 30, 2016 and 2015 was \$1,087 thousand and \$531 thousand, respectively.

**14. Geographic and Segment Information**

The Company had previously reported its results of operations under one operating segment. During the second quarter of 2015, organizational changes were made to (i) realign the Company's businesses and organizational structure and (ii) streamline and consolidate certain business processes to achieve greater operating efficiencies. In furtherance of these objectives, the Company combined its Display Solutions and Power Solutions business lines into a new segment called Standard Products Group. Beginning in the second quarter of 2015, the Company began reporting its financial results in two operating segments: Semiconductor Manufacturing Services and Standard Products Group. During the third quarter of 2015, the Company changed the name of its Semiconductor Manufacturing Services segment to Foundry Services Group. The Company's chief operating decision maker is its Chief Executive Officer who allocates resources and assesses performance of the business and other activities based on gross profit. The two newly established operating segments were managed prospectively and all prior period amounts related to the segment change have been retrospectively reclassified to conform to the new presentation.

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The following sets forth information relating to the operating segment:

|                               | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|-------------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                               | <b>June 30,</b>           | <b>June 30,</b> | <b>June 30,</b>         | <b>June 30,</b> |
|                               | <b>2016</b>               | <b>2015</b>     | <b>2016</b>             | <b>2015</b>     |
| <b>Net Sales</b>              |                           |                 |                         |                 |
| Foundry Services Group        | \$ 62,310                 | \$ 78,962       | \$ 122,289              | \$ 153,482      |
| Standard Products Group       |                           |                 |                         |                 |
| Display Solutions             | 74,406                    | 48,918          | 132,465                 | 105,271         |
| Power Solutions               | 30,213                    | 33,995          | 60,131                  | 67,832          |
| Total Standard Products Group | 104,619                   | 82,913          | 192,596                 | 173,103         |
| All other                     | 177                       | 140             | 326                     | 315             |
| Total net sales               | \$ 167,106                | \$ 162,015      | \$ 315,211              | \$ 326,900      |

|                         | <b>Three Months Ended</b> |                 | <b>Six Months Ended</b> |                 |
|-------------------------|---------------------------|-----------------|-------------------------|-----------------|
|                         | <b>June 30,</b>           | <b>June 30,</b> | <b>June 30,</b>         | <b>June 30,</b> |
|                         | <b>2016</b>               | <b>2015</b>     | <b>2016</b>             | <b>2015</b>     |
| <b>Gross Profit</b>     |                           |                 |                         |                 |
| Foundry Services Group  | \$ 14,187                 | \$ 17,183       | \$ 28,480               | \$ 32,560       |
| Standard Products Group | 22,385                    | 17,963          | 43,145                  | 37,388          |
| All other               | 177                       | 140             | (627)                   | 315             |
| Total gross profit      | \$ 36,749                 | \$ 35,286       | \$ 70,998               | \$ 70,263       |

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

|                                 | <b>Three Months Ended</b> |                 |
|---------------------------------|---------------------------|-----------------|
|                                 | <b>June 30,</b>           | <b>June 30,</b> |
|                                 | <b>2016</b>               | <b>2015</b>     |
| Korea                           | \$ 46,822                 | \$ 61,755       |
| Asia Pacific (other than Korea) | 100,107                   | 75,582          |
| U.S.A.                          | 8,338                     | 20,310          |
| Europe                          | 11,749                    | 3,708           |
| Others                          | 90                        | 660             |
| Total                           | \$ 167,106                | \$ 162,015      |

**Six Months Ended**

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|                                 | <b>June 30,<br/>2016</b> | <b>June 30,<br/>2015</b> |
|---------------------------------|--------------------------|--------------------------|
| Korea                           | \$ 97,450                | \$ 124,225               |
| Asia Pacific (other than Korea) | 181,900                  | 154,759                  |
| U.S.A.                          | 13,114                   | 39,680                   |
| Europe                          | 22,266                   | 7,361                    |
| Others                          | 481                      | 875                      |
| <br>Total                       | <br>\$ 315,211           | <br>\$ 326,900           |

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Net sales from the Company's top ten largest customers accounted for 68% and 65% for the three months ended June 30, 2016 and 2015, respectively, and 65% and 66% for the six months ended June 30, 2016 and 2015, respectively.

For the three months ended June 30, 2016, the Company had one customer that represented 29.4% of its net sales, and for the six months ended June 30, 2016, the Company had two customers that represented 24.3% and 11.0%, respectively.

For the three months ended June 30, 2015, the Company had two customers that represented 14.8% and 10.8% of its net sales, respectively. For the six months ended June 30, 2015, the Company had three customers that represented 15.1%, 11.3% and 10.1% of its net sales, respectively.

96% of the Company's property, plant and equipment are located in Korea as of June 30, 2016.

**15. Accumulated Other Comprehensive Loss**

Accumulated other comprehensive loss consists of the following as of June 30, 2016 and December 31, 2015, respectively:

|  | <b>June 30,<br/>2016</b> | <b>December 31,<br/>2015</b> |
|--|--------------------------|------------------------------|
| Foreign currency translation adjustments | \$ (43)                  | \$ (190)                     |
| Derivative adjustments                   |                          | (41)                         |
| <b>Total</b>                             | <b>\$ (43)</b>           | <b>\$ (231)</b>              |

Changes in accumulated other comprehensive loss for the three months ended June 30, 2016 and 2015 are as follows:

| <b>Three Months Ended June 30, 2016</b>                          | <b>Foreign<br/>currency<br/>translation<br/>adjustments</b> | <b>Derivative<br/>adjustments</b> | <b>Total</b> |
|--|---|-----------------------------------|--------------|
| Beginning balance  | \$ (6,210)  | \$ 24                             | \$ (6,186)   |
| Other comprehensive income (loss) before reclassifications       | 6,167   | (24)                              | 6,143        |
| Amounts reclassified from accumulated other comprehensive income |   |                                   |              |
| Net current-period other comprehensive income (loss)             | 6,167   | (24)                              | 6,143        |
| Ending balance   | \$ (43)   | \$                                | \$ (43)      |

| <b>Three Months Ended June 30, 2015</b>                          | <b>Foreign<br/>currency<br/>translation<br/>adjustments</b> | <b>Derivative<br/>adjustments</b> | <b>Total</b> |
|--|---|-----------------------------------|--------------|
| Beginning balance  | \$ (32,495)   | \$                                | \$ (32,495)  |
| Other comprehensive income (loss) before reclassifications       | 10,123  | (1,417)                           | 8,706        |
| Amounts reclassified from accumulated other comprehensive income |   |                                   |              |
| Net current-period other comprehensive income (loss)             | 10,123  | (1,417)                           | 8,706        |
| Ending balance   | \$ (22,372)   | \$ (1,417)                        | \$ (23,789)  |

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Changes in accumulated other comprehensive loss for the six months ended June 30, 2016 and 2015 are as follows:

| <b>Six Months Ended June 30, 2016</b>                            | <b>Foreign<br/>currency<br/>translation<br/>adjustments</b> | <b>Derivative<br/>adjustments</b> | <b>Total</b> |
|--|---|-----------------------------------|--------------|
| Beginning balance  | \$ (190)  | \$ (41)                           | \$ (231)     |
| Other comprehensive income before reclassifications              | 147   | 41                                | 188          |
| Amounts reclassified from accumulated other comprehensive income |   |                                   |              |
| Net current-period other comprehensive income                    | 147   | 41                                | 188          |
| Ending balance   | \$ (43)   | \$                                | \$ (43)      |

| <b>Six Months Ended June 30, 2015</b>                            | <b>Foreign<br/>currency<br/>translation<br/>adjustments</b> | <b>Derivative<br/>adjustments</b> | <b>Total</b> |
|--|---|-----------------------------------|--------------|
| Beginning balance  | \$ (35,551)   | \$ 485                            | \$ (35,066)  |
| Other comprehensive income (loss) before reclassifications       | 13,179  | (1,417)                           | 11,762       |
| Amounts reclassified from accumulated other comprehensive income |   | (485)                             | (485)        |
| Net current-period other comprehensive income (loss)             | 13,179  | (1,902)                           | 11,277       |
| Ending balance   | \$ (22,372)   | \$ (1,417)                        | \$ (23,789)  |

**16. Loss per Share**

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

|   | <b>Three Months Ended</b> |                          |
|---|---------------------------|--------------------------|
|   | <b>June 30,<br/>2016</b>  | <b>June 30,<br/>2015</b> |
| Net loss                                  | \$ (17,816)               | \$ (30,626)              |
| Weighted average common stock outstanding |                           |                          |
| Basic                                     | 34,716,081                | 34,092,402               |



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|                |            |            |
|----------------|------------|------------|
| Diluted        | 34,716,081 | 34,092,402 |
| Loss per share |            |            |
| Basic          | \$ (0.51)  | \$ (0.90)  |
| Diluted        | \$ (0.51)  | \$ (0.90)  |

|   | <b>Six Months Ended</b> |                 |
|---|-------------------------|-----------------|
|   | <b>June 30,</b>         | <b>June 30,</b> |
|   | <b>2016</b>             | <b>2015</b>     |
| Net loss                                  | \$ (9,691)              | \$ (50,655)     |
| Weighted average common stock outstanding |                         |                 |
| Basic                                     | 34,707,492              | 34,074,534      |
| Diluted                                   | 34,707,492              | 34,074,534      |
| Loss per share                            |                         |                 |
| Basic                                     | \$ (0.28)               | \$ (1.49)       |
| Diluted                                   | \$ (0.28)               | \$ (1.49)       |

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

|                        | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                        | <b>June 30,<br/>2016</b>  | <b>June 30,<br/>2015</b> | <b>June 30,<br/>2016</b> | <b>June 30,<br/>2015</b> |
| Options                | 3,752,331                 | 3,341,700                | 3,752,331                | 3,341,700                |
| Restricted Stock Units | 515,795                   | 129,962                  | 515,795                  | 129,962                  |

**Rights Plan**

On March 5, 2015, the Company entered into a Rights Agreement, dated as of March 5, 2015 between the Company and American Stock Transfer & Trust Company, LLC, as rights agent (the Rights Agreement), and the Board of Directors of the Company authorized and declared a dividend of one preferred stock purchase right (a Right and collectively, the Rights) for each share of the Company's common stock, par value \$0.01 per share, outstanding at the close of business on March 16, 2015. On March 2, 2016, the Company entered into an amendment to the Rights Agreement. As amended, each Right, once exercisable, will entitle the registered holder to purchase from the Company one one-thousandth of a share of Series A Junior Participating Preferred Stock, par value \$0.01 per share, at a purchase price of \$12, subject to adjustment (the Purchase Price). The Rights are not presently exercisable and remain attached to the shares of common stock unless and until the occurrence of the earlier of the following (the

Distribution Date): (i) the tenth day after the public announcement or disclosure by the Company or any person or group of affiliated or associated persons that any person or group of affiliated or associated persons has become an Acquiring Person by obtaining beneficial ownership of 12.5% (or 20% in the case of a passive institutional investor, which is defined generally as any person who has reported beneficial ownership of shares of common stock on Schedule 13G under the Securities Exchange Act of 1934) or more of the Company's outstanding common stock, subject to certain exceptions; or (ii) the tenth business day (or such later date as the Company's Board of Directors may designate before a person or group of affiliated or associated persons becomes an Acquiring Person) after the commencement of, or first public announcement of the intent of any person to commence, a tender or exchange offer by any person or group of affiliated or associated persons, which would, if consummated, result in such person or group becoming an Acquiring Person. The Board of Directors may redeem all of the Rights for \$0.001 per Right at any time before any person or group of affiliated or associated persons becomes an Acquiring Person. In addition, at any time on or after any person or group of affiliated or associated persons becomes an Acquiring Person (but before any person or group of affiliated or associated persons becomes the owner of 50% or more of the Company's outstanding common stock), the Board of Directors may exchange all or part of the Rights (other than the Rights beneficially owned by the Acquiring Person and certain affiliated persons) for shares of common stock at an exchange ratio of one share of common stock per Right. The Rights will expire at the close of business on September 5, 2016, unless redeemed or exchanged prior to that time.

If any person or group of affiliated or associated persons becomes an Acquiring Person, then, after the Distribution Date, each Right (other than Rights beneficially owned by the Acquiring Person and certain affiliated persons or transferees thereof) will entitle the holder to purchase, for the Purchase Price, a number of shares of common stock having a market value of twice the Purchase Price. Alternatively, if, after any person or group of affiliated or associated persons becomes an Acquiring Person, (1) the Company is involved in a merger or other business combination in which the Company is not the surviving corporation or its common stock is changed into or exchanged for other securities or assets; or (2) the Company or one or more of its subsidiaries sell or otherwise transfer assets or earning power aggregating more than 50% of the assets or earning power of the Company and its subsidiaries, taken as a whole, then each Right will entitle the holder to purchase, for the Purchase Price, a number of shares of common

stock of the other party to such business combination or sale (or in certain circumstances, an affiliate) having a market value of twice the Purchase Price.

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**Table of Contents****17. Commitments and Contingencies*****Securities Class Action Complaints***

On March 12, 2014, a purported class action was filed against the Company and certain of the Company's now-former officers. On April 21, 2015, a related purported class action lawsuit (Okla. Police Pension & Retirement Sys. v. MagnaChip Semiconductor Corp., et al., No. 3:15-cv-01797) was filed against the Company, certain of the Company's current directors and former and now-former officers, a shareholder of the Company, and certain financial firms that acted as underwriters of the Company's public stock offerings. On June 15, 2015, these two class action lawsuits were consolidated. On June 26, 2015, an amended complaint was filed in the consolidated action, against the Company, certain of the Company's current directors and former officers, a shareholder of the Company, and certain financial firms that acted as underwriters of the Company's public stock offerings on behalf of a putative class consisting of all persons other than the defendants who purchased or acquired the Company's securities between February 1, 2012 and February 12, 2015 and a putative subclass consisting of all purchasers of the Company's common stock pursuant to or traceable to a shelf registration statement and prospectus issued in connection with the Company's February 6, 2013 public stock offering. The consolidated amended complaint asserts claims on behalf of the putative class for (i) alleged violations of Section 10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder by the Company and certain of the Company's current directors and former officers, (ii) alleged violations of Section 20(a) of the Exchange Act by certain of the Company's current directors and former officers, and (iii) alleged violations of Sections 20(a) and 20(A) of the Exchange Act by a shareholder. The consolidated amended complaint also asserts claims on behalf the subclass for (i) alleged violations of Section 11 of the Securities Act by the Company, certain of the Company's current directors and former officers, and certain financial firms that acted as underwriters of the Company's public stock offerings, (ii) alleged violations of Section 12 of the Securities Act by the Company, certain of the Company's current directors and former officers, a shareholder of the Company, and certain financial firms that acted as underwriters of the Company's public stock offerings, (iii) alleged violations of Section 15 of the Securities Act by the Company, certain of the Company's former officers, and a shareholder of the Company.

On December 10, 2015, the Company and certain of its current and former officers and directors entered into a Memorandum of Understanding with the plaintiffs' representatives to memorialize an agreement in principle to settle the consolidated securities class action lawsuit, Thomas, et al. v. MagnaChip Semiconductor Corp. et al., Civil Action No. 3:14-CV-01160-JST, pending in the United States District Court for the Northern District of California (the Class Action Litigation). On February 5, 2016, the plaintiffs in the consolidated securities class action filed a motion for preliminary approval of the settlement, as well as the stipulation and agreement of settlement and related exhibits. The stipulation and agreement of settlement releases all claims asserted against all defendants in the Class Action Litigation except for Avenue Capital Management II, L.P. and does not release claims asserted in the derivative actions Hemmingson, et al. v. Elkins, et al., No. 1-15-CV-278614 (PHK) (Cal. Super. Ct. Santa Clara Cnty.) and Bushansky v. Norby, et al., No. 1-15-CV-281284 (PHK) (Cal. Super. Ct. Santa Clara Cnty.). The stipulation and agreement of settlement provides for an aggregate settlement payment by the Company of \$23.5 million, which includes all attorneys' fees, costs of administration and plaintiffs' out-of-pocket expenses, lead plaintiff compensatory awards and disbursements. The Company expects the settlement will be fully funded by insurance proceeds. The settlement includes the dismissal of all claims against the Company and the named individuals in the Class Action Litigation without any liability or wrongdoing attributed to them.

On April 13, 2016, plaintiffs filed a renewed motion for preliminary approval of the settlement. On July 18, 2016, the court granted plaintiffs' renewed motion for preliminary approval of the settlement. The court has scheduled the fairness hearing for November 21, 2016. The settlement remains subject to stockholder notice, court approval and other customary conditions.

The Company has recorded the \$23.5 million of the obligation as accrued expenses in the consolidated balance sheets as of December 31, 2015 and as selling, general and administrative expenses in the consolidated statements of operations for the year ended December 31, 2015. The Company has recorded \$29.6 million of the proceeds from the insurers as other receivables in the consolidated balance sheets as of December 31, 2015 and as a deduction of the selling, general and administrative expenses in the consolidated statements of operations for the year ended December 31, 2015. The proceeds from the insurers of \$29.6 million were deposited into the Company's escrow account during the first quarter of 2016. As a result, the Company reclassified the \$29.6 million deposits recorded in other receivables into restricted cash as of March 31, 2016.

***SEC Enforcement Staff Review***

In March 2014, the Company voluntarily reported to the SEC that the Company's Audit Committee had determined that the Company incorrectly recognized revenue on certain transactions and as a result would restate its financial statements, and that the Audit Committee had commenced an independent investigation. Over the course of 2014 and the first two quarters of 2015, the Company voluntarily produced documents to the SEC regarding the various accounting issues identified during the independent investigation, and whether the Company's hiring of an accountant from the Company's independent registered public accounting firm impacted that accounting firm's independence. On July 22, 2014, the Staff of the SEC's Division of Enforcement obtained a Formal

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Order of Investigation. On March 12, 2015, the SEC issued a subpoena for documents to the Company in connection with its investigation. The Company will continue to cooperate with the SEC in this investigation, and has produced documents in response to the subpoena. 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.

***Shareholder Derivative Complaints***

A shareholder derivative action, styled Hemmingson et al. v. Elkins et al., Case No. 1-15-cv-278614, was filed in the Superior Court of the State of California in and for Santa Clara County on March 25, 2015, naming as defendants certain of the Company's current directors and former and now-former officers, as well as a shareholder of the Company, and naming the Company as a nominal defendant. The complaint in this action asserts claims for (i) alleged breaches of fiduciary duty by certain of the Company's current directors and former and now-former officers for purportedly knowingly failing to maintain adequate internal controls over its accounting and reporting functions and disseminating to shareholders certain alleged materially false and misleading statements, (ii) alleged breaches of fiduciary duty by certain of the Company's current directors and a current shareholder of the Company for purported insider trading, and (iii) alleged unjust enrichment by a shareholder of the Company for purported insider trading.

On June 1, 2015, a shareholder derivative action was filed in the Superior Court of the State of California, Santa Clara County styled Bushansky v. Norby, et al., No. 1-15-CV-281284 (PHK) (Cal. Super. Ct. Santa Clara Cnty.). The complaint names as defendants certain of the Company's current directors and former officers, and a shareholder of the Company, with the Company being named as a nominal defendant. The complaint asserts claims for (i) alleged breaches of fiduciary duties by certain of the Company's current directors and former officers for knowingly failing to maintain adequate internal controls over the Company's accounting and reporting functions and disseminating to shareholders certain alleged materially false and misleading statements; and (ii) alleged aiding and abetting of such breaches of fiduciary duties by all defendants.

On January 22, 2016, the Company and the plaintiffs in the Hemmingson and Bushansky actions entered into and filed a stipulation of settlement with the Superior Court of the State of California, Santa Clara County. The settlement provides for the resolution of all of the pending claims in both shareholder derivative actions against the Company and the individual defendants, without any liability or wrongdoing attributed to them. The settlement provides for an aggregate payment from the Company defendants' directors and officers insurance policies of \$3.0 million to be made to an escrow account, which will be remitted to the Company once the settlement becomes final, less (i) any applicable costs of such escrow account, (ii) any amount awarded by the court to the plaintiff's counsel for attorney's fees and litigation expenses and (iii) the cost of providing notice of the settlement to the Company's stockholders. The proposed settlement also requires that the Company implement certain corporate governance measures. On February 22, 2016, plaintiffs filed an unopposed motion for preliminary approval of the proposed derivative settlement. On June 10, 2016, the court granted plaintiffs' motion for preliminary approval of the proposed settlement. The court has scheduled a hearing on final approval of the proposed settlement for October 7, 2016. The proposed settlement remains subject to final court approval and other customary conditions.

**18. Subsequent Events*****Securities Class Action Complaints***

As more fully disclosed in Note 17, "Commitments and Contingencies", on December 10, 2015, the Company and certain of its current and former officers and directors entered into a Memorandum of Understanding with the plaintiffs' representatives to memorialize an agreement in principle to settle the Class Action Litigation. On July 18, 2016, the court granted plaintiffs' renewed motion for preliminary approval of the settlement. The court has scheduled

the fairness hearing for November 21, 2016. The settlement remains subject to stockholder notice, court approval and other customary conditions.

*Derivative Contracts*

In August 2016, the Company and the counterparty, Nomura Financial Investment (Korea) Co., Ltd., entered into derivative contracts of zero cost collars for September and the fourth quarter of the year ending December 31, 2016. The total notional amount of these derivatives is \$40 million. In connection with these contracts, the Company paid \$2.5 million in cash deposits to the counterparty in August 2016.

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**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 II: Item 1A. Risk Factors in our annual report on Form 10-K for the fiscal year ended December 31, 2015.

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

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



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

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

#### **Overview**

We are a Korea-based designer and manufacturer of analog and mixed-signal semiconductor products for consumer, computing, communication, industrial, automotive and IoT applications. We provide technology platforms for analog, mixed-signal, power, high voltage, non-volatile memory, and RF applications. We have a proven record with a 30-year operating history, large portfolio of 2,277 registered novel patents and 159 pending novel patent applications and extensive engineering and manufacturing process expertise.

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

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

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

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

Demand for our products and services is driven by overall demand for consumer, computing, communication, industrial, automotive and IoT products and can be adversely affected by periods of weak consumer and enterprise spending or by market share losses by our customers. In order to mitigate the impact of market volatility on our business, we are diversifying our portfolio of products, customers, and target applications. We also expect that new competitors will emerge in these markets that may place increased pressure on the pricing for our products and services. While we believe we are well positioned competitively to compete in these markets and against these new

competitors as a result of our long operating history, existing manufacturing capacity and our Korea-based operations, if we are not effective in competing in these markets our operating results may be adversely affected.

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

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

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

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

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

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

## ***Recent Developments***

In December 2014, we announced that our Board of Directors had adopted a plan to close our 6-inch fab. During the fourth quarter of 2015, we received \$8.2 million deposit for sale of machinery in conjunction with the planned closure of 6-inch fab. According to this plan, the 6-inch fab was closed on February 29, 2016. During the first of 2016, we

completed all procedures necessary to sell all machineries in our closed 6-inch fab and recognized the \$7.8 million of restructuring gain from this related deposit of \$8.2 million, net of certain direct selling costs. On April 4, 2016, we commenced a voluntary resignation program (the Program), which was available to certain manufacturing employees, including our 6-inch fab employees, through April 29, 2016.

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

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**Table of Contents*****Restatement***

In January 2014, our Audit Committee commenced an independent investigation that resulted in the restatement of certain financial statements for prior periods. As a result of the restatement, we have incurred substantial external accounting, legal and other related costs associated with the restatement and certain litigation and other regulatory investigations and actions related thereto. We incurred restatement related costs of \$5.9 million, primarily attributable to certain litigation, for the six months ended June 30, 2016, compared to \$11.4 million for the six months ended June 30, 2015. On December 10, 2015, we entered into a Memorandum of Understanding with the plaintiffs representatives to settle the Class Action Litigation, as defined and detailed in Item 1. Interim Consolidated Financial Statements Notes to Consolidated Financial Statements Note 17. Commitments and Contingencies in this Report, for an aggregate settlement payment of \$23.5 million. This settlement payment is expected to be fully funded by insurance proceeds that were received in the first quarter of 2016 and recorded as restricted cash as of June 30, 2016.

***Segments***

We had previously reported our results of operations under one operating segment. During the second quarter of 2015, organizational changes were made to (i) realign our businesses and organizational structure and (ii) streamline and consolidate certain business processes to achieve greater operating efficiencies. Accordingly, we combined our business lines of Display Solutions and Power Solutions into a new segment called Standard Products Group. Beginning in the second quarter of 2015, we began to report our financial results in two operating segments: Semiconductor Manufacturing Services and Standard Products Group. During the third quarter of 2015, we changed the name of our Semiconductor Manufacturing Services segment to Foundry Services Group. We identified these segments based on how we allocate resources and assess our performance.

***Foundry Services Group:*** Our Foundry Services Group provides specialty analog and mixed-signal foundry services to fabless semiconductor companies and IDMs that serve consumer, computing, communication, industrial, automotive and IoT applications. We manufacture wafers based on our customers' product designs. We do not market these products directly to end customers but rather supply manufactured wafers and products to our customers to market to their end customers. We offer approximately 473 process flows to our foundry services customers. We also often partner with key customers to jointly develop or customize specialized processes that enable our customers to improve their products and allow us to develop unique manufacturing expertise. Our foundry services target customers who require differentiated, specialty analog and mixed-signal process technologies such as high voltage complementary metal-oxide-semiconductor (CMOS), embedded memory or bipolar-CMOS-DMOS (BCD). These customers typically serve the consumer, computing, communication, industrial, automotive and IoT applications. Our Foundry Services Group business represented 38.8% and 47.0% of our net sales for the six months ended June 30, 2016 and June 30, 2015, respectively. Gross profit from our Foundry Services Group business was \$28.5 million and \$32.6 million for the six months ended June 30, 2016 and June 30, 2015, respectively.

***Standard Products Group:*** Our Standard Products Group includes our Display Solutions and Power Solutions business lines. Our Display Solutions products include source and gate drivers and timing controllers that cover a wide range of flat panel displays used in ultra high definition (UHD), high definition (HD), light emitting diode (LED), 3D and OLED televisions and displays, notebooks and mobile communications and entertainment devices. Our Display Solutions products support the industry's most advanced display technologies, such as active matrix organic light emitting diodes

(AMOLEDs), and low temperature polysilicons (LTPS), as well as high-volume display technologies such as thin film transistors (TFT). Since 2007, we have designed and manufactured AMOLED display driver IC products. Our current portfolio of AMOLED solutions address a wide range of resolutions ranging from HD to Wide Quad High Definition (WQHD) for applications including smartphones, TVs, and other mobile devices. According to IHS, we were the second largest manufacturer of the mobile AMOLED display driver ICs in the fourth quarter of 2015 based on unit shipments. We believe we have a unique intellectual property portfolio and mixed-signal design and manufacturing expertise in the AMOLED industry. We provide a full range of intelligent sensor product families featuring 0.18 micron analog and mixed-signal technology with low power consumption. Our sensor families target the growing market for applications ranging from smartphone, tablet PC and other consumer electronics to industrial devices. Our Power Solutions business line produces power management semiconductor products including discrete and integrated circuit solutions for power management in high-volume consumer applications. These products include metal oxide semiconductor field effect transistors (MOSFETs), insulated-gate bipolar transistors (IGBTs), 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 Standard Products Group, which includes our Display Solutions and Power Solutions business lines, represented 61.1% and 53.0% of our net sales for the six months ended June 30, 2016 and June 30, 2015, respectively. Gross profit from our Standard Products Group was \$43.1 million and \$37.4 million for the six months ended June 30, 2016 and June 30, 2015, respectively.

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**Explanation and Reconciliation of Non-US GAAP Measures**

***Adjusted EBITDA and Adjusted Net Loss***

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

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

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.

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

for planning purposes, including the preparation of our annual operating budget;

to evaluate the effectiveness of our enterprise level business strategies;

in communications with our Board of Directors concerning our consolidated financial performance; and

in certain of our compensation plans as a performance measure for determining incentive compensation payments.

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

determined in accordance with US GAAP. A reconciliation of net income (loss) to Adjusted EBITDA is as follows:

|  | <b>Three Months</b>  |                   | <b>Three Months</b> |                   |
|--|----------------------|-------------------|---------------------|-------------------|
|  | <b>Ended</b>         | <b>Six Months</b> | <b>Ended</b>        | <b>Six Months</b> |
|  | <b>June</b>          | <b>Ended</b>      | <b>June 30,</b>     | <b>Ended</b>      |
|  | <b>30,</b>           | <b>June 30,</b>   | <b>June 30,</b>     | <b>June 30,</b>   |
|  | <b>2016</b>          | <b>2016</b>       | <b>2015</b>         | <b>2015</b>       |
|  | <b>(In millions)</b> |                   |                     |                   |
| Net loss                               | \$ (17.8)            | \$ (9.7)          | \$ (30.6)           | \$ (50.7)         |
| Interest expense, net                  | 4.0                  | 8.0               | 3.9                 | 8.0               |
| Income tax expenses (benefits)         | 0.3                  | 1.1               | (0.6)               | 0.5               |
| Depreciation and amortization          | 6.2                  | 12.3              | 6.8                 | 13.7              |
| EBITDA                                 | \$ (7.3)             | \$ 11.6           | \$ (20.5)           | \$ (28.5)         |
| Adjustments:                           |                      |                   |                     |                   |
| Restructuring and other (gain), net(a) | 5.5                  | (1.3)             |                     |                   |
| Equity-based compensation expense(b)   | 1.0                  | 1.5               | 1.8                 | 2.0               |
| Foreign currency loss (gain), net(c)   | 7.1                  | (1.1)             | 12.3                | 15.5              |
| Derivative valuation gain, net(d)      | 0.0                  | 0.0               | 0.3                 | 0.3               |
| Restatement related expenses(e)        | 2.3                  | 5.9               | 5.2                 | 11.4              |
| Adjusted EBITDA                        | \$ 8.6               | \$ 16.6           | \$ (0.9)            | \$ 0.7            |

- (a) This adjustment eliminates the impact associated with the closure of our 6-inch fab. For the six months ended June 30, 2016, the adjustment eliminates the \$7.8 million restructuring gain on sale of machinery in connection with the closure of our 6-inch fab, net of the \$4.2 million other termination benefits payable under the voluntary resignation program and \$2.3 million training and transition costs related to our 6-inch fab employees. For the three months ended June 30, 2016, the adjustment eliminates the \$4.2 million other termination benefits payable under the voluntary resignation program and \$1.3 million training and transition costs related to our 6-inch fab employees.



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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 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 in connection with the Audit Committee's independent investigation and related restatement and litigation, primarily comprised of legal, audit and consulting fees. Partially offsetting the restatement related expenses for the six months ended June 30, 2015 was proceeds from an insurance claim for defense costs. This amount does not include any allocation of internal costs related to the restatement.

There was no tax impact from the adjustments to net loss to calculate our Adjusted EBITDA for the three and six months ended June 30, 2016 and 2015 due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets.

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

Adjusted EBITDA does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;

Adjusted EBITDA does not reflect changes in, or cash requirements for, our working capital needs;

Adjusted EBITDA does not reflect the interest expense, or the cash requirements necessary to service interest or principal payments, on our debt;

although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often 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 Loss as a further supplemental measure of our performance. We prepare Adjusted Net Loss 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 Loss is particularly useful because it reflects the impact of our asset base and capital structure on our operating performance. We present Adjusted Net Loss for a number of reasons, including:

we use Adjusted Net Loss in communications with our Board of Directors concerning our consolidated financial performance;

we believe that Adjusted Net Loss is an enterprise level performance measure commonly reported and widely used by analysts and investors in our industry; and

our investor and analyst presentations may include Adjusted Net Loss.

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

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

|  | <b>Three Months</b>  |                   | <b>Three Months</b> | <b>Six Months</b> |
|--|----------------------|-------------------|---------------------|-------------------|
|  | <b>Ended</b>         | <b>Six Months</b> |                     |                   |
|  | <b>June</b>          | <b>Ended</b>      | <b>June 30,</b>     | <b>June 30,</b>   |
|  | <b>30,</b>           | <b>June 30,</b>   | <b>June 30,</b>     | <b>June 30,</b>   |
|  | <b>2016</b>          | <b>2016</b>       | <b>2015</b>         | <b>2015</b>       |
|  | <b>(In millions)</b> |                   |                     |                   |
| Net loss                                 | \$ (17.8)            | \$ (9.7)          | \$ (30.6)           | \$ (50.7)         |
| Adjustments:                             |                      |                   |                     |                   |
| Restructuring and other (gain), net(a)   | 5.5                  | (1.3)             |                     |                   |
| Equity-based compensation expense(b)     | 1.0                  | 1.5               | 1.8                 | 2.0               |
| Foreign currency loss (gain), net(c)     | 7.1                  | (1.1)             | 12.3                | 15.5              |
| Derivative valuation loss (gain), net(d) | 0.0                  | 0.0               | 0.3                 | 0.3               |
| Restatement related expenses(e)          | 2.3                  | 5.9               | 5.2                 | 11.4              |
| Adjusted Net Loss                        | \$ (1.9)             | \$ (4.7)          | \$ (11.1)           | \$ (21.5)         |

- (a) This adjustment eliminates the impact associated with the closure of our 6-inch fab. For the six months ended June 30, 2016, the adjustment eliminates the \$7.8 million restructuring gain on sale of machinery in connection with the closure of our 6-inch fab, net of the \$4.2 million other termination benefits payable under the voluntary resignation program and \$2.3 million training and transition costs related to our 6-inch fab employees. For the three months ended June 30, 2016, the adjustment eliminates the \$4.2 million other termination benefits payable under the voluntary resignation program and \$1.3 million training and transition costs related to our 6-inch fab employees.
- (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 in connection with the Audit Committee's independent investigation and related restatement and litigation, primarily comprised of legal, audit and consulting fees. Partially offsetting the

restatement related expenses for the six months ended June 30, 2015 was proceeds from an insurance claim for defense costs. This amount does not include any allocation of internal costs related to the restatement. There was no tax impact from the adjustments to net loss to calculate our Adjusted Net Loss for the three and six months ended June 30, 2016 and 2015 due to net operating loss carry-forwards available to offset taxable income and full allowance for deferred tax assets.

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

Adjusted Net Loss does not reflect our cash expenditures, or future requirements, for capital expenditures or contractual commitments;

Adjusted Net Loss does not reflect changes in, or cash requirements for, our working capital needs;

Adjusted Net Loss does not consider the potentially dilutive impact of issuing equity-based compensation to our management team and employees;

Adjusted Net Loss does not reflect the costs of holding certain assets and liabilities in foreign currencies; and

other companies in our industry may calculate Adjusted Net Loss differently than we do, limiting its usefulness as a comparative measure.

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Because of these limitations, Adjusted Net Loss 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 Loss only supplementally.

### **Factors Affecting Our Results of Operations**

**Net Sales.** We derive virtually all of our sales (net of sales returns and allowances) from two segments: Foundry Services Group and Standard Products Group. Our product inventory is primarily located in Korea and is available for drop shipment globally. Outside of Korea, we maintain limited product inventory, and our sales representatives generally relay orders to our factories in Korea for fulfillment. We have strategically located our sales and technical support offices near concentrations of major customers. Our sales offices are located in Korea, the United States, Japan and Greater China. Our network of authorized agents and distributors consists of agents in the United States and Europe and distributors and agents in the Asia Pacific region. Our net sales from All other consist principally of the disposal of 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 six months ended June 30, 2016 and 2015, we sold products to 277 and 268 customers, respectively, and our net sales to our ten largest customers represented 65% and 66% of our net sales, respectively. We have a combined production capacity of approximately 115,000 semiconductor wafers per month. We believe our large-scale, cost-effective fabrication facilities enable us to rapidly adjust our production levels to meet shifts in demand by our end customers.

**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.

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

**Labor Costs.** A significant portion of our employees are located in Korea. Under Korean labor laws, most employees and certain executive officers with one or more years of service are entitled to severance benefits upon the termination of their employment based on their length of service and rate of pay. As of June 30, 2016, 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 depreciate 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.

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

**Interest Expense.** Our interest expense is incurred primarily under 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. Moreover, our foreign currency gain or loss would be affected by changes in the exchange rate between the Korean won and the U.S. dollar as a substantial portion of non-cash translation gain or loss is associated with the intercompany long-term loans to our Korean subsidiary, which is denominated in U.S. dollars. As of June 30, 2016, the outstanding intercompany loan balance including accrued interests between our Korean subsidiary and our Dutch subsidiary was \$594 million. As a result of such foreign currency fluctuations, it could be more difficult to detect underlying trends in our business and results of operations. In addition, to the extent that fluctuations in currency exchange rates cause our results of operations to differ from our expectations or the expectations of our investors, the trading price of our stock could be adversely affected.

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

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

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

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.



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***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.

**Table of Contents****Results of Operations Comparison of Three Months Ended June 30, 2016 and 2015**

The following table sets forth consolidated results of operations for the three months ended June 30, 2016 and 2015:

|  | Three Months Ended<br>June 30, 2016 |                   | Three Months Ended<br>June 30, 2015 |                   | Change<br>Amount |
|--|-------------------------------------|-------------------|-------------------------------------|-------------------|------------------|
|  | Amount                              | % of<br>Net Sales | Amount                              | % of<br>Net Sales |                  |
|  | (In millions)                       |                   |                                     |                   |                  |
| Net sales                                    | \$ 167.1                            | 100.0%            | \$ 162.0                            | 100.0%            | \$ 5.1           |
| Cost of sales                                | 130.4                               | 78.0              | 126.7                               | 78.2              | 3.6              |
| Gross profit                                 | 36.7                                | 22.0              | 35.3                                | 21.8              | 1.5              |
| Selling, general and administrative expenses | 25.9                                | 15.5              | 28.6                                | 17.6              | (2.6)            |
| Research and development expenses            | 18.2                                | 10.9              | 21.9                                | 13.5              | (3.8)            |
| Operating loss                               | (7.4)                               | (4.4)             | (15.2)                              | (9.4)             | 7.9              |
| Interest expense                             | (4.1)                               | (2.4)             | (4.0)                               | (2.5)             | (0.1)            |
| Foreign currency gain (loss), net            | (7.1)                               | (4.2)             | (12.3)                              | (7.6)             | 5.2              |
| Others, net                                  | 1.0                                 | 0.6               | 0.3                                 | 0.2               | 0.7              |
|  | (10.2)                              | (6.1)             | (16.0)                              | (9.9)             | 5.8              |
| Loss before income taxes                     | (17.5)                              | (10.5)            | (31.2)                              | (19.3)            | 13.7             |
| Income tax expenses (benefits)               | 0.3                                 | (0.2)             | (0.6)                               | (0.4)             | 0.9              |
| Net loss                                     | \$ (17.8)                           | (10.7)            | \$ (30.6)                           | (18.9)            | \$ 12.8          |

**Results by segment**

|                               | Three Months Ended<br>June 30, 2016 |                   | Three Months Ended<br>June 30, 2015 |                   | Change<br>Amount |
|-------------------------------|-------------------------------------|-------------------|-------------------------------------|-------------------|------------------|
|                               | Amount                              | % of<br>Net Sales | Amount                              | % of<br>Net Sales |                  |
|                               | (In millions)                       |                   |                                     |                   |                  |
| <b>Net Sales</b>              |                                     |                   |                                     |                   |                  |
| Foundry Services Group        | \$ 62.3                             | 37.3%             | \$ 79.0                             | 48.7%             | \$ (16.7)        |
| Standard Products Group       |                                     |                   |                                     |                   |                  |
| Display Solutions             | 74.4                                | 44.5              | 48.9                                | 30.2              | 25.5             |
| Power Solutions               | 30.2                                | 18.1              | 34.0                                | 21.0              | (3.8)            |
| Total Standard Products Group | 104.6                               | 62.6              | 82.9                                | 51.2              | 21.7             |

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|                 |          |        |          |        |        |
|-----------------|----------|--------|----------|--------|--------|
| All other       | 0.2      | 0.1    | 0.1      | 0.1    |        |
| Total net sales | \$ 167.1 | 100.0% | \$ 162.0 | 100.0% | \$ 5.1 |

|                         | <b>Three Months Ended<br/>June 30, 2016</b> |                           | <b>Three Months Ended<br/>June 30, 2015</b> |                           | <b>Change<br/>Amount</b> |
|-------------------------|---|---------------------------|---|---------------------------|--------------------------|
|                         | <b>Amount</b>                               | <b>% of<br/>Net Sales</b> | <b>Amount</b>                               | <b>% of<br/>Net Sales</b> |                          |
| <b>Gross Profit</b>     |   |                           |   |                           |                          |
| Foundry Services Group  | \$ 14.2                                     | 22.8%                     | \$ 17.2                                     | 21.8%                     | \$ (3.0)                 |
| Standard Products Group | 22.4  | 21.4                      | 18.0  | 21.7                      | 4.4                      |
| All other               | 0.2   | 100.0                     | 0.1   | 100.0                     | 0.1                      |
| Total gross profit      | \$ 36.7                                     | 22.0                      | \$ 35.3                                     | 21.8                      | \$ 1.5                   |

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**Table of Contents*****Net Sales***

Net sales were \$167.1 million for the three months ended June 30, 2016, a \$5.1 million, or 3.1%, increase compared to \$162.0 million for the three months ended June 30, 2015. This increase was primarily due to an increase in revenue related to our Standard Products Group, which was offset in part by a decrease in net sales from our Foundry Services Group as described below.

***Foundry Services Group.*** Net sales from our Foundry Services Group segment were \$62.3 million for the three months ended June 30, 2016, a \$16.7 million, or 21.1%, decrease compared to \$79.0 million for the three months ended June 30, 2015. The decrease was primarily attributable to an \$11.1 million revenue decline due to the closure of our 6-inch fab in the first quarter of 2016 and a \$10.3 million decrease caused by reduced levels of demand for our foundry services from customers serving the high-end and mid-range smartphone markets. These decreases were partially offset by a \$6.5 million increase in sales of certain products from new global power management IC foundry customers.

***Standard Products Group.*** Net sales from our Standard Products Group segment were \$104.6 million for the three months ended June 30, 2016, a \$21.7 million, or 26.2%, increase compared to \$82.9 million for the three months ended June 30, 2015. This increase was primarily due to an increase in revenue related to our Display Solutions business line, partially offset by a decrease in revenue related to our Power Solutions business line as described below.

Net sales from our Display Solutions business line were \$74.4 million for the three months ended June 30, 2016, a \$25.5 million, or 52.1%, increase from \$48.9 million for the three months ended June 30, 2015. This significant increase in sales was primarily attributable to \$35.1 million higher sales of mobile AMOLED display driver IC, which was partially offset by an \$8.6 million decrease due to reduced demand for source drivers among large display products, primarily for TVs and notebooks. Net sales from our Power Solutions business line were \$30.2 million for the three months ended June 30, 2016, a \$3.8 million, or 11.1%, decrease from \$34.0 million for the three months ended June 30, 2015. The decrease in sales was primarily due to reduction of low margin MOSFET products as part of our product portfolio optimization process.

***All Other.*** All other net sales were \$0.2 million for the three months ended June 30, 2016 and \$0.1 million for the three months ended June 30, 2015, respectively.

***Gross Profit***

Total gross profit was \$36.7 million for the three months ended June 30, 2016 compared to \$35.3 million for the three months ended June 30, 2015, a \$1.5 million, or 4.1%, increase. Gross profit as a percentage of net sales for the three months ended June 30, 2016 increased to 22.0% compared to 21.8% for the three months ended June 30, 2015. The slight increase in gross profit as a percentage of net sales was primarily due to an increase in gross profit from our Foundry Services Group segment, partially offset by a decrease in gross profit from our Standard Products Group segment as described below.

***Foundry Services Group.*** Gross profit from our Foundry Services Group segment was \$14.2 million for the three months ended June 30, 2016, a \$3.0 million, or 17.4%, decrease compared to \$17.2 million for the three months ended June 30, 2015. Gross profit as a percentage of net sales for the three months ended June 30, 2016 increased to 22.8% compared to 21.8% for the three months ended June 30, 2015. The increase in gross profit as a percentage of net sales was mainly attributable to better product mix without legacy low margin products that were manufactured in our closed 6-inch fab.

**Standard Products Group.** Gross profit from our Standard Products Group segment was \$22.4 million for the three months ended June 30, 2016, a \$4.4 million, or 24.6%, increase from \$18.0 million for the three months ended June 30, 2015. Gross profit as a percentage of net sales for the three months ended June 30, 2016 slightly decreased to 21.4% compared to 21.7% for the three months ended June 30, 2015. The slight decrease in gross profit as a percentage of net sales was attributable to a decrease in the average selling price of legacy products, partially offset by an increase in the volume of products manufactured at an external foundry.

**All Other.** All other gross profit was \$0.2 million for the three months ended June 30, 2016 and \$0.1 million for the three months ended June 30, 2015, respectively.

**Table of Contents*****Net Sales by Geographic Region***

We report net sales by geographic region based on the location to which the products are billed. The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the three months ended June 30, 2016 and 2015:

|                                 | <b>Three Months Ended<br/>June 30, 2016</b> |                           | <b>Three Months Ended<br/>June 30, 2015</b> |                           | <b>Change<br/>Amount</b> |
|---------------------------------|---|---------------------------|---|---------------------------|--------------------------|
|                                 | <b>Amount</b>                               | <b>% of<br/>Net Sales</b> | <b>Amount</b>                               | <b>% of<br/>Net Sales</b> |                          |
|                                 |   |                           | <b>(In millions)</b>                        |                           |                          |
| Korea                           | \$ 46.7                                     | 28.0%                     | \$ 61.7                                     | 38.1%                     | \$ (14.9)                |
| Asia Pacific (other than Korea) | 100.1                                       | 59.9                      | 75.6  | 46.7                      | 24.5                     |
| United States                   | 8.3   | 5.0                       | 20.3  | 12.5                      | (12.0)                   |
| Europe                          | 11.7  | 7.0                       | 3.7   | 2.3                       | 8.0                      |
| Others                          | 0.1   | 0.1                       | 0.7   | 0.4                       | (0.6)                    |
|                                 | \$ 167.1                                    | 100.0%                    | \$ 162.0                                    | 100.0%                    | \$ 5.1                   |

Net sales in Korea for the three months ended June 30, 2016 decreased from \$61.7 million to \$46.7 million compared to the three months ended June 30, 2015, or by \$14.9 million, or 24.2%, primarily due to reduced demand of large display applications primarily for TVs and notebooks and due to a decrease in sales in connection with the closure of our 6-inch fab in the first quarter of 2016.

Net sales in Asia Pacific (other than Korea) for the three months ended June 30, 2016 increased from \$75.6 million to \$100.1 million compared to the three months ended June 30, 2015, or by \$24.5 million, or 32.4%, primarily due to higher sales of mobile AMOLED display products driver IC, which was partially offset by reduced demand for MOSFET products and decrease in sales in connection with the closure of our 6-inch fab in the first quarter of 2016.

Net sales in the United States for the three months ended June 30, 2016 decreased from \$20.3 million to \$8.3 million compared to the three months ended June 30, 2015, or by \$12.0 million, or 58.9%, primarily due to the change in billing location from the United States to Europe by a foundry customer serving the high-end smartphone market and the decrease in demand of the foundry customer.

Net sales in Europe for the three months ended June 30, 2016 increased from \$3.7 million to \$11.7 million compared to the three months ended June 30, 2015, or by \$8.0 million, or 216.9%, primarily due to the change in billing location from the United States to Europe by a foundry customer serving the high-end smartphone market.

***Operating Expenses***

***Selling, General and Administrative Expenses.*** Selling, general and administrative expenses were \$25.9 million, or 15.5% of net sales, for the three months ended June 30, 2016, compared to \$28.6 million, or 17.6% of net sales, for the three months ended June 30, 2015. The decrease of \$2.6 million, or 9.2%, was attributable to a \$3.6 million decrease in professional fees mainly comprised of legal and consulting fees, a \$1.3 million decrease in separation cost and a \$1.1 million decrease in equity-based compensation. These decreases were partially offset by a \$4.2 million increase in other termination benefit expenses under our voluntary resignation program.

**Research and Development Expenses.** Research and development expenses were \$18.2 million, or 10.9% of net sales, for the three months ended June 30, 2016, compared to \$21.9 million, or 13.5% of net sales, for the three months ended June 30, 2015. The decrease of \$3.8 million, or 17.1%, was primarily due to a decrease in material and personnel costs.

**Operating Loss**

As a result of the foregoing, operating loss decreased by \$7.9 million, or 51.6%, in the three months ended June 30, 2016 compared to the three months ended June 30, 2015. As discussed above, the decrease in operating loss resulted from a \$1.5 million increase in gross profit, a \$2.6 million decrease in selling, general and administrative expenses and a \$3.8 million decrease in research and development expenses.

**Other Income (Expense)**

**Interest Expense.** Interest expense was \$4.1 million for the three months ended June 30, 2016 and \$4.0 million for the three months ended June 30, 2015.

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***Foreign Currency Loss, Net.*** Net foreign currency loss for the three months ended June 30, 2016 was \$7.1 million compared to net foreign currency loss of \$12.3 million for the three months ended June 30, 2015. 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 or loss from intercompany balances was included in determining our consolidated net income since the intercompany balances were not considered long-term investments in nature because management intended to settle these intercompany balances at their respective maturity dates.

***Others, Net.*** Others were comprised of gains and losses on valuation of derivatives which were designated as hedging instruments, rental income and interest income. Others for the three months ended June 30, 2016 and June 30, 2015 was \$1.0 million and \$0.3 million, respectively.

***Income Tax Expenses***

Income tax expenses for the three months ended June 30, 2016 were \$0.3 million and income tax benefits for the three months ended June 30, 2015 were \$0.6 million. The increase in income tax expenses of \$0.9 million was primarily attributable to the decrease in reversal amounts of uncertain tax positions due to a lapse of the applicable statute of limitations in the Korean subsidiary.

***Net Loss***

As a result of the foregoing, net loss decreased by \$12.8 million in the three months ended June 30, 2016 compared to the three months ended June 30, 2015. As discussed above, the decrease primarily resulted from a \$7.9 million decrease in operating loss mainly attributable to a reduction in certain operating expenses and a \$5.2 million decrease in net foreign currency loss.



**Table of Contents****Results of Operations Comparison of Six Months Ended June 30, 2016 and 2015**

The following table sets forth consolidated results of operations for the six months ended June 30, 2016 and 2015:

|  | Six Months Ended<br>June 30, 2016 |                   | Six Months Ended<br>June 30, 2015 |                   | Change<br>Amount |
|--|-----------------------------------|-------------------|-----------------------------------|-------------------|------------------|
|  | Amount                            | % of<br>Net Sales | Amount                            | % of<br>Net Sales |                  |
| (In millions)                                |                                   |                   |                                   |                   |                  |
| Net sales                                    | \$ 315.2                          | 100.0%            | \$ 326.9                          | 100.0%            | \$ (11.7)        |
| Cost of sales                                | 244.2                             | 77.5              | 256.6                             | 78.5              | (12.4)           |
| Gross profit                                 | 71.0                              | 22.5              | 70.3                              | 21.5              | 0.7              |
| Selling, general and administrative expenses | 45.9                              | 14.6              | 53.6                              | 16.4              | (7.7)            |
| Research and development expenses            | 36.0                              | 11.4              | 44.1                              | 13.5              | (8.1)            |
| Restructuring gain                           | (7.8)                             | (2.5)             |                                   |                   | (7.8)            |
| Operating loss                               | (3.1)                             | (1.0)             | (27.4)                            | (8.4)             | 24.3             |
| Interest expense                             | (8.1)                             | (2.6)             | (8.0)                             | (2.4)             | (0.1)            |
| Foreign currency gain (loss), net            | 1.1                               | (0.3)             | (15.5)                            | (4.7)             | 16.6             |
| Others, net                                  | 1.5                               | 0.5               | 0.8                               | 0.2               | 0.7              |
|  | (5.5)                             | (1.7)             | (22.7)                            | (6.9)             | 17.2             |
| Loss before income taxes                     | (8.6)                             | (2.7)             | (50.1)                            | (15.3)            | 41.5             |
| Income tax expenses                          | 1.1                               | 0.3               | 0.5                               | 0.2               | 0.6              |
| Net loss                                     | \$ (9.7)                          | (3.1)             | \$ (50.7)                         | (15.5)            | \$ 41.0          |

**Results by segment**

|                         | Six Months Ended<br>June 30, 2016 |                   | Six Months Ended<br>June 30, 2015 |                   | Change<br>Amount |
|-------------------------|-----------------------------------|-------------------|-----------------------------------|-------------------|------------------|
|                         | Amount                            | % of<br>Net Sales | Amount                            | % of<br>Net Sales |                  |
| (In millions)           |                                   |                   |                                   |                   |                  |
| <b>Net Sales</b>        |                                   |                   |                                   |                   |                  |
| Foundry Services Group  | \$ 122.3                          | 38.8%             | \$ 153.5                          | 47.0%             | \$ (31.2)        |
| Standard Products Group |                                   |                   |                                   |                   |                  |
| Display Solutions       | 132.5                             | 42.0              | 105.3                             | 32.2              | 27.2             |
| Power Solutions         | 60.1                              | 19.1              | 67.8                              | 20.8              | (7.7)            |

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|                               |          |        |          |        |           |
|-------------------------------|----------|--------|----------|--------|-----------|
| Total Standard Products Group | 192.6    | 61.1   | 173.1    | 53.0   | 19.5      |
| All other                     | 0.3      | 0.1    | 0.3      | 0.1    | 0.0       |
| Total net sales               | \$ 315.2 | 100.0% | \$ 326.9 | 100.0% | \$ (11.7) |

|                            | <b>Six Months Ended<br/>June 30, 2016</b> |                           | <b>Six Months Ended<br/>June 30, 2015</b> |                           | <b>Change<br/>Amount</b> |
|----------------------------|---|---------------------------|---|---------------------------|--------------------------|
|                            | <b>Amount</b>                             | <b>% of<br/>Net Sales</b> | <b>Amount</b>                             | <b>% of<br/>Net Sales</b> |                          |
|                            | <b>(In millions)</b>                      |                           |   |                           |                          |
| <b><i>Gross Profit</i></b> |   |                           |   |                           |                          |
| Foundry Services Group     | \$ 28.5                                   | 23.3%                     | \$ 32.6                                   | 21.2%                     | \$ (4.1)                 |
| Standard Products Group    | 43.1                                      | 22.4                      | 37.4                                      | 21.6                      | 5.8                      |
| All other                  | (0.6)                                     | (192.3)                   | 0.3                                       | 100.1                     | (0.9)                    |
| Total gross profit         | \$ 71.0                                   | 22.5                      | \$ 70.3                                   | 21.5                      | \$ 0.7                   |

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**Table of Contents*****Net Sales***

Net sales were \$315.2 million for the six months ended June 30, 2016, an \$11.7 million, or 3.6%, decrease compared to \$326.9 million for the six months ended June 30, 2015. This decrease was primarily attributable to a decrease in revenue from our Foundry Services Group due to the closure of our 6-inch fab in the first quarter of 2016, which was offset in part by an increase in net sales from our Standard Products Group as described below.

***Foundry Services Group.*** Net sales from our Foundry Services Group segment were \$122.3 million for the six months ended June 30, 2016, a \$31.2 million, or 20.3%, decrease compared to net sales of \$153.5 million for the six months ended June 30, 2015. The decrease was primarily attributable to a \$14.1 million revenue decline due to the closure of our 6-inch fab in the first quarter of 2016 and \$20.4 million decrease caused by reduced levels of demand of our foundry services from customers serving the high-end and mid-range smartphone markets. These decreases were partially offset by a \$7.5 million increase in sales of certain products from new global power management IC foundry customers.

***Standard Products Group.*** Net sales from our Standard Products Group segment were \$192.6 million for the six months ended June 30, 2016, a \$19.5 million, or 11.3%, increase compared to \$173.1 million for the six months ended June 30, 2015. This increase was primarily due to an increase in revenue related to our Display Solutions business line, partially offset by decrease in revenue related to our Power Solutions business line as described below.

Net sales from our Display Solutions business line were \$132.5 million for the six months ended June 30, 2016, a \$27.2 million, or 25.8%, increase from \$105.3 million for the six months ended June 30, 2015. The increase in sales was primarily attributable to \$40.8 million higher sales of mobile AMOLED display driver IC, which was partially offset by a \$14.7 million revenue decrease due to reduced demand for source drivers among large display products, primarily for TVs and notebooks. Net sales from our Power Solutions business line were \$60.1 million for the six months ended June 30, 2016, a \$7.7 million, or 11.4%, decrease from \$67.8 million for the six months ended June 30, 2015. The decrease in sales was primarily due to the reduction of low margin MOSFET products as part of our product portfolio optimization process.

***All Other.*** All other net sales were \$0.3 million for the six months ended June 30, 2016 and June 30, 2015.

***Gross Profit***

Total gross profit was \$71.0 million for the six months ended June 30, 2016 compared to \$70.3 million for the six months ended June 30, 2015, a \$0.7 million, or 1.0%, increase. Gross profit as a percentage of net sales for the six months ended June 30, 2016 increased to 22.5% compared to 21.5% for the six months ended June 30, 2015. The increase in gross profit as a percentage of net sales was primarily due to an increase in gross profit from our Foundry Services Group segment and Standard Products Group segment as described below.

***Foundry Services Group.*** Gross profit from our Foundry Services Group segment was \$28.5 million for the six months ended June 30, 2016, a \$4.1 million, or 12.5%, decrease compared to \$32.6 million for the six months ended June 30, 2015. Gross profit as a percentage of net sales for the six months ended June 30, 2016 increased to 23.3% compared to 21.2% for the six months ended June 30, 2015. The increase in gross profit as a percentage of net sales was mainly attributable to better product mix without legacy low margin products that were manufactured in our closed 6-inch fab.

***Standard Products Group.*** Gross profit from our Standard Products Group segment was \$43.1 million for the six months ended June 30, 2016, a \$5.8 million, or 15.4%, increase from \$37.4 million for the six months ended June 30,

2015. Gross profit as a percentage of net sales for the six months ended June 30, 2016 increased to 22.4% compared to 21.6% for the six months ended June 30, 2015. The increase in gross profit as a percentage of net sales was attributable to lower unit costs due to our continuing cost reduction effort and a decrease in inventory reserves as a result of improved inventory management.

**All Other.** All other gross profit for the six months ended June 30, 2016 was negative \$0.6 million mainly attributable to training and transition costs related to our 6-inch fab employees, which was partially offset by revenue from the disposal of waste materials. All other gross profit for the six months ended June 30, 2015 was \$0.3 million related to the disposal of waste materials.

**Table of Contents****Net Sales by Geographic Region**

We report net sales by geographic region based on the location to which the products are billed. The following table sets forth our net sales by geographic region and the percentage of total net sales represented by each geographic region for the six months ended June 30, 2016 and 2015:

|                                 | Six Months Ended<br>June 30, 2016 |                   | Six Months Ended<br>June 30, 2015 |                   | Change<br>Amount |
|---------------------------------|-----------------------------------|-------------------|-----------------------------------|-------------------|------------------|
|                                 | Amount                            | % of<br>Net Sales | Amount                            | % of<br>Net Sales |                  |
|                                 | (In millions)                     |                   |                                   |                   |                  |
| Korea                           | \$ 97.5                           | 30.9%             | \$ 124.2                          | 38.0%             | \$ (26.8)        |
| Asia Pacific (other than Korea) | 181.9                             | 57.7              | 154.8                             | 47.3              | 27.1             |
| United States                   | 13.1                              | 4.2               | 39.7                              | 12.1              | (26.6)           |
| Europe                          | 22.3                              | 7.1               | 7.4                               | 2.3               | 14.9             |
| Others                          | 0.5                               | 0.2               | 0.9                               | 0.3               | (0.4)            |
|                                 | \$ 315.2                          | 100.0%            | \$ 326.9                          | 100.0%            | \$ (11.7)        |

Net sales in Korea for the six months ended June 30, 2016 decreased from \$124.2 million to \$97.5 million compared to the six months ended June 30, 2015, or by \$26.8 million, or 21.6%, primarily due to reduced demand of large display applications for TVs and notebooks and a decrease in sales in connection with the closure of our 6-inch fab in the first quarter of 2016.

Net sales in Asia Pacific for the six months ended June 30, 2016 increased from \$154.8 million to \$181.9 million compared to the six months ended June 30, 2015, or by \$27.1 million, or 17.5%, primarily due to higher sales of mobile display products, which was partially offset by reduced sales of MOSFET products and our foundry services due to the closure of our 6-inch fab in the first quarter of 2016.

Net sales in the United States for the six months ended June 30, 2016 decreased from \$39.7 million to \$13.1 million compared to the six months ended June 30, 2015, or by \$26.6 million, or 67.0%, primarily due to the change in billing location from the United States to Europe by a foundry customer serving the high-end smartphone market and a decrease in demand of the foundry customer.

Net sales in Europe for the six months ended June 30, 2016 increased from \$7.4 million to \$22.3 million compared to the six months ended June 30, 2015, or by \$14.9 million, or 202.5%, primarily due to the change in billing location from the United States to Europe by a foundry customer serving the high-end smartphone market.

**Operating Expenses**

**Selling, General and Administrative Expenses.** Selling, general, and administrative expenses were \$45.9 million, or 14.6% of net sales, for the six months ended June 30, 2016, compared to \$53.6 million, or 16.4% of net sales, for the six months ended June 30, 2015. The decrease of \$7.7 million, or 14.3%, was attributable to a \$6.3 million decrease in professional fees mainly comprised of legal and consulting fees, a \$2.5 million decrease related to a reversal of a non-income-based tax accrual, a \$1.3 million decrease in separation costs and a \$0.7 million decrease in equity-based compensation. These decreases were partially offset by a \$4.2 million increase in other termination benefit expenses

under our voluntary resignation program.

**Research and Development Expenses.** Research and development expenses were \$36.0 million, or 11.4% of net sales, for the six months ended June 30, 2016, compared to \$44.1 million, or 13.5% of net sales, for the six months ended June 30, 2015. The decrease of \$8.1 million, or 18.4%, was due to a \$2.9 million decrease in personnel costs, a \$2.0 million decrease in material costs and a \$3.2 million reduction in outside service fees and various overhead expenses.

**Restructuring Gain.** Restructuring gain of \$7.8 million recorded for the six months ended June 30, 2016 resulted from the sale of machinery related to the closure of our 6-inch fab.

### **Operating Loss**

As a result of the foregoing, operating loss decreased by \$24.3 million in the six months ended June 30, 2016 compared to the six months ended June 30, 2015. As discussed above, the decrease in operating loss resulted from a \$7.7 million decrease in selling, general and administrative expenses, an \$8.1 million decrease in research and development expenses and a \$7.8 million increase in restructuring gain.

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***Other Income (Expense)***

***Interest Expense.*** Interest expense was \$8.1 million for the six months ended June 30, 2016 and \$8.0 million for the six months ended June 30, 2015.

***Foreign Currency Gain (Loss), Net.*** Net foreign currency gain for the six months ended June 30, 2016 was \$1.1 million compared to net foreign currency loss of \$15.5 million for the six months ended June 30, 2015. 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 or loss from intercompany balances was included in determining our consolidated net income since the intercompany balances were not considered long-term investments in nature because management intended to settle these intercompany balances at their respective maturity dates.

***Others, Net.*** Others were comprised of gains and losses on the valuation of derivatives which were designated as hedging instruments, rental income and interest income. Others for the six months ended June 30, 2016 and June 30, 2015 was \$1.5 million and \$0.9 million, respectively.

***Income Tax Expenses***

Income tax expenses for the six months ended June 30, 2016 and 2015 were \$1.1 million and \$0.5 million respectively. The increase in income tax expenses of \$0.6 million was primarily attributable to the decrease in reversal amounts of uncertain tax positions due to a lapse of the applicable statute of limitations in the Korean subsidiary during the second quarter of 2016 and a reversal of deferred tax assets at a foreign subsidiary during the first quarter of 2015.

***Net Loss***

As a result of the foregoing, net loss significantly decreased by \$41.0 million in the six months ended June 30, 2016 compared to the six months ended June 30, 2015. As discussed above, the decrease primarily resulted from a \$24.3 million decrease in operating loss attributable to reduction in certain operating expenses and a \$7.8 million restructuring gain, and a \$16.6 million decrease in net foreign currency loss.

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### **Liquidity and Capital Resources**

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

Our principal sources of liquidity are our cash, cash equivalents, our cash flows from operations and our financing activities. Our ability to manage cash and cash equivalents may be limited, as our primary cash flows are dictated by the terms of our sales and supply agreements, contractual obligations, debt instruments and legal and regulatory requirements. From time to time, we may sell accounts receivable to third parties under factoring agreements or engage in accounts receivable discounting to facilitate the collection of cash. For a description of our factoring arrangements and accounts receivable discounting, please see Item 1. Interim Consolidated Financial Statements Notes to Consolidated Financial Statements Note 2. Sales of Accounts Receivable and Receivable Discount Program included elsewhere in this Report. In addition, from time to time, we may make payments to our vendors on extended terms with their consent. As of June 30, 2016, we do not have any accounts payable on extended terms or payment deferment with our vendors.

Our cash balance at December 31, 2015 was \$90.9 million compared to \$83.9 million at June 30, 2016, both of which were impacted positively by approximately \$10.0 million of customer prepayments, respectively. Those customers paid cash prior to risk of loss of products being transferred based on the terms of the arrangements. Our cash balance at December 31, 2015 was also impacted positively by approximately \$8.2 million as a result of equipment deposits received with respect to the then-planned closure of our 6-inch fabrication facility.

Since fiscal 2015, we have implemented a comprehensive cost reduction program to reduce spending and improve our cash flows. Our ability to maintain sufficient liquidity for the next twelve months to fund our operations and capital expenditures and implement our business plan and strategy will also be dependent on continuing improvement in our operating results. We currently believe that we will have sufficient cash reserves from cash on hand and expected cash from operations to fund our operations and planned capital expenditures for the next twelve months. However, if our operating results do not continue to improve, we may need to seek additional capital. There can be no assurance that any additional equity or debt financing would be available to us, or if available, that such financing would be on favorable terms to us. Accordingly, if we are unable to obtain additional capital or our business does not generate sufficient cash flows from operating activities to fund our working capital needs and planned capital expenditures, and our cash reserves are depleted, we may need to take various actions, such as down-sizing and/or eliminating certain operations, which could include additional exit costs, reducing or delaying capital expenditures, selling assets, or other restructuring actions.

Additionally, many of the aspects of management's plan, growth strategies and cost reduction initiatives to conserve our liquidity position involve management's judgments and estimates that include factors that may be beyond our control, and actual results could differ materially from our current expectations. As a result, these and other factors could cause our business plans, strategies and cost reduction initiatives to be unsuccessful, which could have a material adverse effect on our operating results, financial condition and liquidity.

As of June 30, 2016, cash and cash equivalents held by our Korean subsidiary were \$70.0 million, which represents 83% of our total cash and cash equivalents of \$83.9 million on a consolidated basis. We, as a holding company resident in the United States, issued our 2021 Notes. Payments under our outstanding 2021 Notes are currently funded in part by our Korean subsidiary's repayment of its existing loans from our Dutch subsidiary, with our Dutch subsidiary using such repayments in turn to repay the loans owed to our Luxembourg subsidiary, which repays loans owed to us. Repatriation of funds could have potential adverse tax consequences.



***Cash Flows from Operating Activities***

Cash outflow used in operating activities totaled \$8.7 million for the six months ended June 30, 2016, compared to \$27.5 million for the six months ended June 30, 2015. The net operating cash outflow for the six months ended June 30, 2016 reflects our net loss of \$9.7 million, non-cash adjustments of \$15.2 million which mainly consisted of depreciation and amortization, provision for severance benefits and foreign currency gain, and a decrease in net operating liabilities of \$14.2 million.

Our working capital balance as of June 30, 2016 was \$88.7 million compared to \$93.7 million as of December 31, 2015. The \$5.0 million decrease was primarily attributable to an \$8.8 million decrease in accounts receivables and an \$8.8 million increase in accounts payables, which were partially offset by a \$12.8 million increase in inventories.

***Cash Flows from Investing Activities***

Cash outflow used in investing activities totaled \$0.01 million for the six months ended June 30, 2016, compared to \$9.2 million for the six months ended June 30, 2015. The decrease was primarily attributable to a \$12.5 million net decrease in hedge collateral and a \$1.0 million net decrease in guarantee deposits, which were partially offset by a \$4.1 million net increase in capital expenditures.

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***Cash Flows from Financing Activities***

There were no cash flows generated from financing activities for the six months ended June 30, 2016, compared to \$1.2 million of cash inflow provided by financing activities for the six months ended June 30, 2015. The financing cash inflow for the six months ended June 30, 2015 consists of proceeds received from the issuance of common stock in connection with exercised options.

***Capital Expenditures***

We routinely make capital expenditures to enhance our existing facilities and reinforce our global research and development capability. For the six months ended June 30, 2016, capital expenditures were \$6.3 million, a \$4.1 million, or 183.4%, increase from \$2.2 million for the six months ended June 30, 2015. The increase was due to supporting technology improvements at our fabrication facilities in anticipation of attaining manufacturing efficiency.



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

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

We believe that our significant accounting policies, which are described further in Note 1 to our consolidated financial statements in the 2015 Form 10-K, are critical due to the fact that they involve a high degree of judgment and estimates about the effects of matters that are inherently uncertain. We base these estimates and judgments on historical experience, knowledge of current conditions and other assumptions and information that we believe to be reasonable. Estimates and assumptions about future events and their effects cannot be determined with certainty. Accordingly, these estimates may change as new events occur, as more experience is acquired, as additional information is obtained and as the business environment in which we operate changes.

A description of our critical accounting policies that involve significant management judgement appears in the 2015 Form 10-K, under Management's Discussion and Analysis of Financial Conditions and Reports of Operations Critical Accounting Policies and Estimates. There have been no material changes to our critical accounting policies and estimates as compared to our critical accounting policies and estimates included in the 2015 Form 10-K, except for the following:

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***Vendor Rebates*** We, from time to time, entered into arrangements whereby rebates are obtained from vendors when we achieve certain levels of purchases. The vendor rebates are computed at an agreed upon amount or percentage of purchase levels. As these vendor rebates are impacted by actual and estimated purchases for the applicable agreed upon period, we periodically assess the progress of our purchase levels and revise the estimates when necessary. We account for such rebates as a reduction of inventory until we sell the product, at which time such rebates are reflected as a reduction of cost of sales in our consolidated statements of operations. Vendor rebates recorded as a reduction of inventory were \$0.2 million as of June 30, 2016 and as a reduction of cost of sales were \$1.2 million for the six months ended June 30, 2016.

***Recent Accounting Pronouncements***

For a full description of new accounting pronouncements and recently adopted accounting pronouncements, including the respective dates and impact of adoption on our consolidated financial statements, please see Item 1. Interim Consolidated Financial Statements Notes to Consolidated Financial Statements Note 1. Business, Basis of Presentation and Significant Accounting Policies in this Report.

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**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 June 30, 2016 for our Korean subsidiary, a 10% devaluation of the Korean won against the U.S. dollar would have resulted in a decrease of \$1.2 million in our U.S. dollar financial instruments and cash balances.

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

***Interest Rate Exposures***

As of June 30, 2016, \$225.0 million aggregate principal amount of our 2021 Notes were outstanding. Interest on the 2021 Notes accrues at a fixed rate of 6.625% per annum and is paid semi-annually every January 15 and July 15 of each year until the 2021 Notes mature on July 15, 2021. Since the interest rate is fixed, we have no market risk related to the 2021 Notes.

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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 our periodic reports filed 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, with the participation of our Chief Executive Officer and Chief Financial Officer, as appropriate, 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 Chief Executive Officer and Chief Financial Officer, as of June 30, 2016, of the effectiveness of the design and operation of our disclosure controls and procedures, as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act. Based upon this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of June 30, 2016, as we cannot conclude that the material weaknesses in internal control over financial reporting described in Part II, Item 9A of our 2015 Form 10-K have been remediated as of the date of this Report.

#### ***Previously Identified Material Weaknesses***

As previously disclosed in our 2015 Form 10-K, management concluded that, based on the criteria set forth in Internal Control Integrated Framework (2013) 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, 2015 to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with US GAAP. For more information on material weaknesses in internal control over financial reporting, see Part II, Item 9A of our 2015 Form 10-K.

#### ***Remediation Efforts***

As previously disclosed in Part II, Item 9A of our 2015 Form 10-K, we have enhanced various internal controls that relate to (i) Period End Closing and Financial Reporting and (ii) Income Tax Accounting and Disclosures. However, controls over (x) the completeness and accuracy of non-routine manual journal entries and (y) the analysis and review of current income taxes will not be considered fully remediated until those controls operate effectively as redesigned for a sufficient period of time by the end of 2016.

#### ***Changes in Internal Control Over Financial Reporting***

There were no changes in our internal control over financial reporting during the quarter ended June 30, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

For a discussion of legal proceedings, see Part I: Item 3. Legal Proceedings of our 2015 Form 10-K.

See also Part I: Item 1A. Risk Factors of our 2015 Form 10-K and Notes 17 and 18 to our consolidated financial statements in this Report for additional information.

**Item 1A. Risk Factors**

The Company is subject to risks and uncertainties, any of which could have a significant or material adverse effect on our business, financial condition, liquidity or consolidated financial statements. You should carefully consider the risk factors disclosed in Part I, Item 1A of our 2015 Form 10-K and other reports we have filed with the SEC. The risks described herein and therein are not the only ones we face. This information should be considered carefully together with the other information contained in this Report and the other reports and materials the Company files with the SEC.

There are no material changes to the Company's risk factors disclosed in Part I: Item 1A. Risk Factors of our 2015 Form 10-K and Part II: Item 1A. Risk Factors of our Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2016.



**Table of Contents****Item 6. Exhibits.**

| <b>Exhibit</b> |   |
|----------------|---|
| <b>Number</b>  | <b>Description</b>  |
| 3.1            | Amended and Restated Bylaws of MagnaChip Semiconductor Corporation, effective May 3, 2016 (incorporated by reference to Exhibit 3.1 to our Current Report on Form 8-K filed on May 6, 2016).  |
| 10.1           | Settlement Agreement, dated as of May 26, 2016, by and among MagnaChip Semiconductor Corporation, Engaged Capital, LLC, Engaged Capital Master Feeder I, LP, Engaged Capital Master Feeder II, LP, Engaged Capital I, LP, Engaged Capital I Offshore, Ltd., Engaged Capital II, LP, Engaged Capital II Offshore Ltd., Engaged Capital Holdings, LLC and Glenn W. Welling (incorporated by reference to Exhibit 10.1 to our Current Report on Form 8-K filed on May 27, 2016). |
| 10.2#          | Amendment to Basic Contract on Joint Development and Grant of License, dated as of May 18, 2016, by and between MagnaChip Semiconductor, Ltd. and Silicon Works Co., Ltd. (English translation).  |
| 31.1#          | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Executive Officer.   |
| 31.2#          | Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934 of the Chief Financial Officer.   |
| 32.1           | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Executive Officer.   |
| 32.2           | Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, of the Chief Financial Officer.   |
| 101.INS#       | XBRL Instance Document.   |
| 101.SCH#       | XBRL Taxonomy Extension Schema Document.  |
| 101.CAL#       | XBRL Taxonomy Extension Calculation Linkbase Document.  |
| 101.DEF#       | XBRL Taxonomy Extension Definition Linkbase Document.   |
| 101.LAB#       | XBRL Taxonomy Extension Label Linkbase Document.  |
| 101.PRE#       | XBRL Taxonomy Extension Presentation Linkbase Document.   |
| Footnotes:     |   |

# Filed herewith  
Furnished herewith

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**SIGNATURES**

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

MAGNACHIP SEMICONDUCTOR CORPORATION

(Registrant)

Dated: August 5, 2016

By: /s/ Young-Joon Kim  
Young-Joon Kim  
Chief Executive Officer

(Principal Executive Officer)

Dated: August 5, 2016

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

(Principal Financial and Accounting Officer)

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**INDEX TO EXHIBITS**

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