ULTRA CLEAN HOLDINGS INC
Form 10-Q
August 10, 2009
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended July 3, 2009

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 000-50646

Ultra Clean Holdings, Inc.

(Exact name of registrant as specified in its charter)

Delaware	**61-1430858**
(State or other jurisdiction of incorporation or organization)	***(I.R.S. Employer Identification No.)***
26462 Corporate Avenue, Hayward, California	**94545**
(Address of principal executive offices)	***(Zip Code)***

(510) 576-4400

Registrant s telephone number, including area code

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

Indicate by check mark whether the registrant 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. (Check one):

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

Number of shares outstanding of the issuer s common stock as of July 31, 2009: 21,453,414.

ULTRA CLEAN HOLDINGS, INC.

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION	
ITEM 1. Financial Statements	3
ITEM 2. Management s Discussion And Analysis of Financial Condition And Results Of Operations	15
ITEM 3. Quantitative and Qualitative Disclosures About Market Risk	19
ITEM 4. Controls and Procedures	20
PART II. OTHER INFORMATION	
ITEM 1. Legal Proceedings	20
ITEM 1A. Risk Factors	20
ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds	30
ITEM 3. Defaults Upon Senior Securities	31
ITEM 4. Submission of Matters to a Vote of Security Holders	31
ITEM 5. Other Information	31
ITEM 6. Exhibits	31
Signatures	32

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ULTRA CLEAN HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	July 3, 2009 (Unaudited)	January 2, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 30,200	$ 29,620
Accounts receivable, net of allowance of $538 and $406, respectively	10,326	13,790
Inventory	32,022	39,814
Deferred income taxes		2,451
Prepaid expenses and other	5,056	8,817
Total current assets	77,604	94,492
Equipment and leasehold improvements, net	7,812	8,954
Other long-term assets:		
Purchased intangibles, net	8,987	8,987
Other non-current assets	306	4,978
Total assets	$ 94,709	$ 117,411
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities:		
Bank borrowings	$ 1,971	$ 5,736
Accounts payable	11,192	11,275
Accrued compensation and related benefits	1,284	2,320
Other current liabilities	2,671	1,964
Total current liabilities	17,118	21,295
Long-term debt	14,106	12,735
Deferred rent and other liabilities	4,549	4,982
Total liabilities	35,803	39,012
Commitments and contingencies (See note 8)		
Stockholders equity:		
Preferred stock $0.001 par value, 10,000,000 authorized; none outstanding		
Common stock $0.001 par value, 90,000,000 authorized; 21,441,602 and 21,287,700 shares issued and outstanding, in 2009 and 2008, respectively	95,367	93,757
Common shares held in treasury, at cost, 601,944 shares	(3,337)	(3,337)
Accumulated deficit	(33,124)	(12,021)

Total stockholders equity	58,906	78,399
Total liabilities and stockholders equity	$ 94,709	$ 117,411

(See accompanying notes to condensed consolidated financial statements.)

3

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; in thousands, except per share data)

	Three months ended		Six months ended	
	July 3, 2009	June 27, 2008	July 3, 2009	June 27, 2008
Sales	$ 23,252	$ 67,364	$ 45,652	$ 159,721
Cost of goods sold	24,106	59,842	49,376	140,139
Gross profit (loss)	(854)	7,522	(3,724)	19,582
Operating expenses:				
Research and development	748	606	1,664	1,391
Sales and marketing	1,165	1,327	2,195	2,960
General and administrative	3,517	6,252	8,859	12,882
Total operating expenses	5,430	8,185	12,718	17,233
Income (loss) from operations	(6,284)	(663)	(16,442)	2,349
Interest and other income (expense), net	228	246	423	590
Income (loss) before provision for income taxes	(6,512)	(909)	(16,865)	1,759
Income tax provision (benefit)	7,551	(747)	4,238	32
Net income (loss)	$ (14,063)	$ (162)	$ (21,103)	$ 1,727
Net income (loss) per share:				
Basic	$ (0.66)	$ (0.01)	$ (0.99)	$ 0.08
Diluted	$ (0.66)	$ (0.01)	$ (0.99)	$ 0.08
Shares used in computing net income (loss) per share				
Basic	21,379	21,643	21,341	21,604
Diluted	21,379	21,643	21,341	22,126

(See accompanying notes to condensed consolidated financial statements.)

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in thousands)

	Six months ended	
	July 3, 2009	**June 27, 2008**
Cash flows from operating activities:		
Net income (loss)	$ (21,103)	$ 1,727
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,309	2,400
Deferred income tax	7,363	(536)
Excess tax benefit from stock-based compensation		(238)
Stock-based compensation	1,564	1,921
Changes in assets and liabilities:		
Accounts receivable, net of allowance	3,464	8,207
Inventory	7,792	5,708
Prepaid expenses and other	3,761	(684)
Other non-current assets	(240)	86
Accounts payable	(97)	(14,290)
Accrued compensation and related benefits	(1,036)	(647)
Income taxes payable		(45)
Other liabilities	315	4,323
Net cash provided by operating activities	3,092	7,932
Cash flows from investing activities:		
Purchases of equipment and leasehold improvements	(153)	(8,078)
Net cash provided by (used in) investing activities	(153)	(8,078)
Cash flows from financing activities:		
Principal payments on capital lease obligations	(10)	(10)
Proceeds from bank borrowings	5,500	
Principal payments on short-term debt	(4,726)	
Principal payments on long-term debt	(3,168)	(1,675)
Excess tax benefit from stock-based compensation		238
Proceeds from issuance of common stock	46	717
Net cash used in financing activities	(2,359)	(730)
Net increase (decrease) in cash	580	(876)
Cash and cash equivalents at beginning of period	29,620	33,447
Cash and cash equivalents at end of period	$ 30,200	$ 32,571
Supplemental items:		
Cash paid during the period for:		
Income taxes paid	$	$ 793
Interest paid	$ 209	$ 583

Non-cash investing activities:				
Fixed asset purchases included in accounts payable	$	14	$	32

(See accompanying notes to condensed consolidated financial statements.)

5

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization, Basis of Presentation and Significant Accounting Policies

Organization Ultra Clean Holdings, Inc. (the Company) is a leading developer and supplier of critical subsystems , producing primarily gas delivery systems, chemical mechanical planarization (CMP) subsystems, chemical delivery modules, frame and top plate assemblies and process modules. The Company serves the semiconductor capital equipment, medical device, research, flat panel and solar industries. The Company s products improve efficiency and reduce the costs of our customers design and manufacturing processes. The Company s customers are primarily original equipment manufacturers (OEMs) in the industries the Company serves.

Basis of Presentation The unaudited condensed consolidated financial statements included in this quarterly report on Form 10-Q include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP). This financial information reflects all adjustments which are, in the opinion of the Company, normal, recurring and necessary to present fairly the statements of financial position, results of operations and cash flows for the dates and periods presented. The Company s January 2, 2009 balance sheet data were derived from audited financial statements as of that date. All significant intercompany transactions and balances have been eliminated from the information provided.

The unaudited condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements for the fiscal year ended January 2, 2009, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 19, 2009. The Company s results of operations for the three months ended July 3, 2009 are not necessarily indicative of the results to be expected for any future periods.

In accordance with SFAS 165, the Company evaluated subsequent events through August 7, 2009, the date of issuance of these condensed consolidated financial statements.

Use of Accounting Estimates The presentation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates and judgments on historical experience and on various other assumptions that it believes are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. Actual amounts may differ from those estimates.

Certain Significant Risks and Uncertainties The Company operates in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, any of the following areas could have a negative effect on the Company in terms of its future financial position, results of operations or cash flows: the general state of the U.S. and world economies, the highly cyclical nature of the industries the Company serves; the loss of any of a small number of customers; ability to obtain additional financing; pursuing acquisition opportunities; regulatory changes; fundamental changes in the technology underlying semiconductor, flat panel, solar and medical device manufacturing processes or manufacturing equipment; the hiring, training and retention of key employees; successful and timely completion of product design efforts; and new product design introductions by competitors.

Concentration of Credit Risk Financial instruments which subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company sells its products primarily to semiconductor capital equipment manufacturers in the United States. The Company performs credit evaluations of its customers financial condition and generally requires no collateral.

Significant sales to customers: Applied Materials, Inc., FEI Company, Intuitive Surgical, Inc. and Lam Research Corporation accounted for 10% or more of the Company s sales for a combined total of 91.3% for the three months ended July 3, 2009. Three of these four greater than 10% companies accounted for 80.0% and 80.2% of the Company s sales for the three months ended June 27, 2008 and the six months ended July 3, 2009, respectively, and two of these greater than 10% companies accounted for 70.8% of the combined sales for the six months ended June 27, 2008.

The Company had three significant customers which represented a combined total of 73.1% of accounts receivable at July 3, 2009 whose individual accounts receivable balances were greater than 10%.

Table of Contents

Fair Value of Financial Instruments The Company s financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and bank borrowings. The carrying value of these instruments approximates their fair value because of their short-term nature.

Fiscal Year The Company uses a 52-53 week fiscal year ending on the Friday nearest December 31. All references to quarters refer to fiscal quarters and all references to years refer to fiscal years.

Income Taxes Income taxes are reported under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* (SFAS 109) and, accordingly, deferred taxes are recognized using the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequence attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base, and operating loss and tax credit carry-forwards. Valuation allowances are provided if it is more likely than not that some or all of the deferred tax assets will not be recognized.

The calculation of the Company s tax liabilities involves dealing with uncertainties in the application of complex tax regulations. The Company records liabilities for anticipated tax audit issues based on its estimate of whether, and the extent to which, additional taxes may be due. Actual tax liabilities may be different than the recorded estimates and could result in an additional charge or benefit to the tax provision in the period when the ultimate tax assessment is determined.

Product Warranty The Company provides a warranty on its products for a period of up to two years and provides for warranty costs at the time of sale based on historical activity. The determination of such provisions requires the Company to make estimates of product return rates and expected costs to repair or replace the products under warranty. If actual return rates and/or repair and replacement costs differ significantly from these estimates, adjustments to cost of sales may be required in future periods. Components of the reserve for warranty costs consisted of the following (in thousands):

	Six months ended	
	July 3, 2009	**June 27, 2008**
Beginning balance	$ 164	$ 220
Provisions related to sales	(14)	79
Warranty claims	(68)	(110)
Ending balance	$ 82	$ 189

Revenue Recognition Product revenue is generally recorded upon shipment. In arrangements which specify title transfer upon delivery, revenue is not recognized until the product is delivered. The Company recognizes revenue when persuasive evidence of an arrangement exists, shipment has occurred, price is fixed or determinable and collectability is reasonably assured. If the Company has not substantially completed a product or fulfilled the terms of a sales agreement at the time of shipment, revenue recognition is deferred until completion. The Company s standard arrangement for our customers includes a signed purchase order or contract, no right of return of delivered products and no customer acceptance provisions.

The Company assesses collectability based on the credit worthiness of the customer and past transaction history. The Company performs on-going credit evaluations of customers and does not require collateral from customers.

Research and Development Costs Research and development costs are expensed as incurred.

Net Income (loss) per Share Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding and common equivalent shares from dilutive stock options and restricted stock using the treasury stock method, except when such shares are anti-dilutive.

Comprehensive Income In accordance with SFAS No. 130, *Reporting Comprehensive Income*, the Company reports by major components, and as a single total, the change in its net assets during the period from non-owner sources. Comprehensive income (loss) for all periods presented was the same as net income (loss).

SFAS 131, *Disclosure about Segments in an Enterprise and Related Information* (SFAS 131), establishes standards for the reporting by public business enterprises of information about reportable segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the manner in which management organizes the reportable segments within the Company for making operational decisions and assessments of financial performance. The Company s chief operating decision-maker is considered to be the Chief Executive Officer. The Company operates in one reporting segment.

Table of Contents

Stock-Based Compensation and Deferred Stock-Based compensation The Company maintains stock-based compensation plans which allow for the issuance of equity-based awards to executives and certain employees. These equity-based awards include stock options, restricted stock awards and restricted stock units. The Company also maintains an employee stock purchase plan (ESPP) that provides for the issuance of shares to all eligible employees of the Company at a discounted price.

The Company applies the fair value recognition provisions of SFAS 123(R). The exercise price of each stock option equals the market price of the Company s stock on the date of grant. The weighted average estimated fair value of employee stock option grants for the three and six months ended July 3, 2009, and June 27, 2008, was $0.63 and $0.51, and zero (there were no stock options granted during this period) and $4.71, respectively. The estimated fair value of the Company s equity-based awards, less expected forfeitures, is amortized over the awards vesting periods on a straight-line basis over a weighted average period of four years and will be adjusted for subsequent changes in estimated forfeitures and future option grants. Most options are scheduled to vest over four years and expire no later than ten years from the grant date. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company s stock price as well as assumptions regarding a number of complex and subjective variables. These variables include the expected term of the awards; the Company s expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The Company estimates the expected term of share-based awards granted based, in part, on the Company s historical option term experience. The Company estimates the volatility of its common stock based upon the Company s historical stock price volatility over the length of the expected term of the options. The Company bases the risk-free interest rate that it uses in the option valuation model on U.S. Treasury zero-coupon issues with remaining maturities similar to the expected term of the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records share-based compensation expense only for those awards that are expected to vest. The Company also considers, each quarter, whether there have been any significant changes in facts and circumstances that would affect its forfeiture rate.

The weighted average assumptions used in the model are outlined in the following table:

	Three months ended		Six months ended	
	July 3, 2009	**June 27, 2008**	**July 3, 2009**	**June 27, 2008**
Dividend yield	0.0%		0.0%	0.0%
Expected volatility	70.0%		50.8%	50.0%
Risk-free interest rate	2.3%		2.1%	2.8%
Forfeiture rate	14.0%		15.0%	7.0%
Expected life (in years)	5.6		5.0	5.0

Stock-based compensation expense from stock options and the related income tax benefit from the expense recognized under SFAS 123(R) were $0.8 million and $0.3 million, and $1.6 million and $0.5 million, respectively, for the three and six months ended July 3, 2009, and $0.8 million and $0.7 million, and $1.9 million and zero million, respectively, for the three and six months ended June 27, 2008.

Table of Contents

The following table shows the Company s stock-based compensation expense included in the condensed consolidated statements of operations (in thousands):

	Three months ended		Six months ended	
	July 3, 2009	June 27, 2008	July 3, 2008	June 27, 2008
Cost of sales	$ 216	$ 249	$ 424	$ 503
Research and development	11			62
Sales and marketing	56	91	123	127
General and administrative	492	480	1,017	1,229
	775	820	1,564	1,921
Income tax benefit	(248)	(673)	(500)	(35)
Total stock-based compensation expense	$ 527	$ 147	$ 1,064	$ 1,888

The following table summarizes information with respect to options outstanding at July 3, 2009:

	Number of Shares
Options outstanding at January 2, 2009	2,145,882
Granted	1,086,292
Exercised	(2,750)
Canceled	(153,147)
Options outstanding at July 3, 2009	3,076,277

The total unamortized expense of the Company s unvested options as of July 3, 2009, is $2.4 million.

Employee Stock Purchase Plan

The Company also maintains an employee stock purchase plan (ESPP) that provides for the issuance of shares to all eligible employees of the Company at a discounted price. Under the ESPP, substantially all employees may purchase the Company s common stock through payroll deductions at a price equal to 95 percent of the fair market value of the Company s stock at the end of each applicable purchase period.

Restricted Stock Units and Restricted Stock Awards

During the first quarter of fiscal 2008, the Company began granting Restricted Stock Units (RSU s) to employees as part of the Company s long term equity compensation plan. These RSU s are granted to employees with a per share or unit purchase price of zero dollars and either have time based or performance based vesting. RSU s typically vest over three years, subject to the employee s continued service with the Company. For purposes of determining compensation expense related to these RSU s, the fair value is determined based on the closing market price of the Company s common stock on the date of award. The expected cost of the grant is reflected over the service period, and is reduced for estimated forfeitures. No RSU s were granted during the first quarter ended April 3, 2009. The Company approved and granted 23,833 RSU s during the current quarter with a weighted average fair value of $1.77 per share. As of July 3, 2009, $1.3 million of unrecognized stock-based compensation cost related to RSU s remains to be amortized and is expected to be recognized over an estimated period of two years.

During the current quarter, the Company issued 60,000 shares of restricted stock awards to its outside directors. The weighted average fair value of the shares was $2.07 per share and was determined using the Company s closing market price on the date of grant. These shares fully vest on the one year anniversary of the date of grant. The total unamortized expense of the Company s unvested restricted stock awards as of July 3, 2009, is $0.1 million.

The following table summarizes the Company s restricted stock unit and restricted stock award activity for the six months ended July 3, 2009 (in thousands):

	Number of Shares
Unvested restricted stock units and restricted stock awards at January 2, 2009	448
Granted	83
Vested	(131)
Forfeited	(89)
Unvested restricted stock units and restricted stock awards at July 3, 2009	311

Table of Contents

Impairment of Other Long-lived Assets Purchased intangibles consist of tradenames acquired as part of a purchase business combination. Critical estimates in valuing certain intangible assets include, but are not limited to: future expected cash flows from customer contracts; acquired developed technologies and patents; expected costs to develop the in-process research and development into commercially viable products and estimated cash flows from the projects when completed; the market position of the acquired products; and assumptions about the period of time the tradename will continue to be used in the Company s product portfolio. Based upon these estimates, the tradename asset was assigned an indefinite life and is not being amortized.

Recently Issued Accounting Standards During the second quarter of 2009, the Company adopted FASB Staff Position (FSP) No. 107 and Accounting Principles Board (APB) 28-1, *Disclosures about Fair Value of Financial Instruments*, which requires disclosure about fair value of financial instruments in interim and annual financial statements. FSP 107-1 also amends APB Opinion No. 28, *Interim Financial Reporting* , to require those disclosures in summarized financial information at interim reporting periods. The adoption of FSP No. 107 and APB 28-1 had no financial impact on the Company s condensed consolidated financial statements or related footnotes.

In May 2009, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 165, *Subsequent Events,* which established general accounting standards and disclosure for subsequent events. The Company adopted SFAS No. 165 during its second quarter of 2009, and, in accordance with SFAS No. 165, the Company has evaluated subsequent events through the date its financial statements were issued on August 7, 2009.

In June 2009, the FASB issued Statement No. 168, *The FASB Accounting Standards Codification TM and the Hierarchy of Generally Accepted Accounting Principles* (SFAS 168). SFAS 168 validates the *FASB Accounting Standards Codification* (the Codification) will become the single official source of authoritative U.S. GAAP (other than guidance issued by the SEC), superseding existing FASB, American Institute of Certified Public Accountants, Emerging Issues Task Force (EITF), and related literature. One level of authoritative U.S. GAAP will exist, and all other literature will be considered non-authoritative. SFAS 168 is effective for financial statements issued for interim and annual periods ending after September 15, 2009. The Company will update its disclosures to conform to the Codification in its Form 10-Q for the third quarter of 2009.

During the first quarter of 2009 the Company adopted FASB Staff Position (FSP) No. 142-3, Determination of the Useful Life of Intangible Assets which amends the factors an entity should consider in developing renewal or extension assumptions used in determining the useful life of recognized intangible assets under FASB Statement No. 142, *Goodwill and Other Intangible Assets.* The adoption of FSP 142-3 had no financial impact on the Company s condensed consolidated financial statements or related footnotes.

In April 2009, the FASB issued FSP FAS No. 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly* (FSP 157-4). FSP 157-4 provides additional guidance for estimating fair value when the market activity for an asset or liability has declined significantly. FSP 157-4 is effective for interim and annual periods ending after June 15, 2009 and will be applied prospectively. During the quarter ended June 26, 2009, we adopted FSP 157-4. The adoption of FSP 157-4 did not have a financial impact on the Company s condensed consolidated financial statements or related footnotes.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS 157). SFAS 157 defines fair value, establishes a framework and gives guidance regarding the methods used for measuring fair value, and expands disclosures about fair value measurements. SFAS 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods of those fiscal years. In February 2008, the FASB released a FASB Staff Position (FSP FAS 157-2 *Effective Date of FASB Statement No. 157*) which delayed, to fiscal years beginning after November 15, 2008, the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). Effective December 30, 2007, the Company adopted SFAS 157 as it applies to the Company s financial instruments. During the first quarter of 2009 the Company adopted SFAS 157 for the Company s non-financial assets and non-financial liabilities, without impact to our condensed consolidated financial statements or related footnotes.

Table of Contents

2. Balance Sheet Information (in thousands)

Inventory consisted of the following (in thousands):

	July 3, 2009	January 2, 2009
Raw materials	$ 28,253	$ 32,464
Work in process	7,287	10,008
Finished goods	1,538	1,672
	37,078	44,144
Reserve for obsolescence	(5,055)	(4,330)
Total	$ 32,022	$ 39,814

Table of Contents

Equipment and leasehold improvements, net, consisted of the following (in thousands):

	July 3, 2009	January 2, 2009
Computer equipment and software	$ 5,963	$ 5,858
Furniture and fixtures	443	425
Machinery and equipment	5,309	5,368
Leasehold improvements	9,578	10,893
	21,293	22,544
Accumulated depreciation and amortization	(13,481)	(13,590)
Total	$ 7,812	$ 8,954

3. Borrowing Arrangements

In the second quarter of 2006, the Company entered into a borrowing arrangement and a term loan (Loan Agreement). The Loan Agreement provided senior secured credit facilities in an aggregate principal amount of up to $32.5 million, consisting of a $25.0 million Revolving Line of Credit and a $7.5 million term loan (Original Term Loan). The outstanding balance of the Revolving Line of Credit as of July 3, 2009 was approximately $11.5 million. The Original Term Loan expired on June 29, 2009.

On February 4, 2009, the Company amended its Loan Agreement resulting in a reduction of the revolving credit facility from $25.0 million to $20.0 million while extending its maturity to January 29, 2012, and instituting a new $3.0 million three-year term loan, as amended, also maturing on January 29, 2012. The aggregate amount of the revolving credit facility is subject to a borrowing base equal to 80% of eligible accounts receivable and 45% of eligible inventory (total eligible inventory not to exceed $2.5 million) and is secured by substantially all of our assets. The revolving credit facility bears interest per annum at a variable rate equal to the greater of the bank s stated prime rate or 4% plus a margin of 25 basis points. The new term loan, as amended, bears interest per annum at a variable rate equal to the greater of the bank s stated prime rate or 4% plus a margin of 75 basis points. The revolving credit facility contains certain reporting and financial covenants, including minimum tangible net worth and liquidity ratios, that must be met on a monthly basis in order for the Company to remain in compliance. We are currently in compliance with all covenants in our Loan Agreement.

Interest rates on outstanding loans under the credit facilities were 4.25% per annum during the quarter ended July 3, 2009 and were 4.25% per annum as of July 3, 2009.

The Company also has a $5.0 million equipment loan that is secured by certain of its equipment and expires May 2011. The interest rate and outstanding balance on the equipment loan was 7.6% and $1.9 million, respectively, as of July 3, 2009.

The combined balance outstanding on the Loan Agreement and equipment loan at July 3, 2009 was $16.1 million.

4. Restructuring

During the first quarter of 2009, the Company recorded restructuring charges related to consolidation of its Portland, Oregon facilities under the provisions of SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities*. Restructuring charges were recorded as general and administrative expense of $215,000 based on the estimated fair value of the non-cancelable lease costs, less estimated future sublease income, which will be paid over the estimated vacancy periods through fiscal 2010. The Company s estimated costs to exit these facilities are based on available commercial data.

During the current quarter the Company made payments of $58,000 and reversed $22,000 of estimated future sublease income due to the continued vacancy of the facility. The balance of the restructuring accrual as of July 3, 2009 is $179,000.

The actual loss incurred in exiting these facilities could be different from the Company s estimates.

5. Income Tax

The Company s income tax provision (benefit) based on pretax income for the six months ended July 3, 2009 and June 27, 2008, was 25.1% and 1.8%, respectively.

The Company follows the asset and liability method of accounting for income taxes, which requires recognition of deferred tax liabilities and assets for the expected future tax consequence of temporary differences between the financial statement carrying amounts and the tax basis of assets and liabilities.

The Company assesses, on a quarterly basis, the realizability of its deferred tax assets by evaluating all available evidence, both positive and negative, including: (1) the cumulative results of operations in recent years, (2) the source of recent losses, (3) estimates of future taxable income and (4) the length of operating loss carryforward periods.

During the first quarter of fiscal year 2009, the Company s operating results were a twelve-quarter negative cumulative earnings. The cumulative twelve-quarter loss was considered significant negative evidence which was objective and verifiable and was heavily weighted. Additional negative evidence the Company considered at that time included projections of future losses and the historic volatility of the semiconductor equipment industry. Management assessed future GAAP taxable income, including all sources of taxable income available to realize its deferred tax assets, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carryforwards, taxable income in carryback years and tax-planning strategies. Management considered a tax planning strategy and concluded that the Company has the ability to implement the strategy and intends to execute such strategy. The Company ordinarily would undertake such strategy which would result in the realizability of the deferred tax assets. As such, the Company concluded that it was more likely than not the deferred tax assets would be realized in full.

In the second quarter of 2009, the Company reviewed its assessment of its deferred tax assets. After considering both the positive and negative evidence through the second quarter of fiscal year 2009, the Company determined that it was no longer more-likely-than-not that deferred tax assets would be realized. As a result, the Company recorded a full valuation allowance against those deferred tax assets to reduce them to their estimated net realizable value with a corresponding non-cash charge. The positive evidence considered by the Company in its assessment included lengthy operating loss carryforward periods, a lack of unused expired operating loss carryforwards in the Company s history, and viability to implement the strategy. The negative evidence the Company considered was the operating results for the second quarter of 2009, year to date operating results through the second quarter of 2009, outlook for the remainder of 2009 and into the future, the actual cost of implementing the strategy, the resources involved in executing the strategy and maintaining the infrastructure, and the longer term outlook for Company s industry. In establishing this valuation allowance, the Company is reducing its deferred tax asset value of $7.0 million to zero. The Company recorded a one time tax expense of $7.0 million related to the set up of the valuation allowance in second quarter of 2009. The assessment required considerable judgment on the part of management with respect to benefits that could be realized from future income, as well as the historical operating results and income tax structure.

In connection with the Company s evaluation of its ability to realize its deferred tax assets, the Company reduced its deferred tax assets by $207,000 for its unrecognized tax benefit. However, there was no impact to the total unrecognized tax benefits for the period.

Table of Contents

The following table summarizes the activity related to the Company s unrecognized tax benefits (in thousands):

	Six months ended	
	July 3, 2009	**June 27, 2008**
Balance as of the beginning of period	$ 428	$ 750
Increase (decrease) related to current year tax positions		
Expiration of the statute of limitations for the assessment of taxes		
Balance as of the end of period	$ 428	$ 750

The Company s 2005 and 2006 state income tax return is currently under examination by the California Franchise Tax Board and the Company s 2006 and 2008 tax return is currently under examination by the Internal Revenue Service. The Company is currently open to audit under the statute of limitations by the Internal Revenue Service for fiscal years 2007 and the Company s state income tax returns are open to audit under the statute of limitations for the fiscal years 2007 through 2008.

6. Net Income (Loss) Per Share

Basic net income (loss) per share excludes dilution and is computed by dividing net income (loss) by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock.

The following is a reconciliation of the numerators and denominators used in computing basic and diluted net income (loss) per share (in thousands, except per share data):

	Three months ended		Six months ended	
	July 3, 2009	**June 27, 2008**	**July 3, 2009**	**June 27, 2008**
Numerator:				
Net income (loss)	$ (14,063)	$ (162)	$ (21,103)	$ 1,727
Denominator:				
Shares used in computation basic:				
Weighted average common shares outstanding	21,379	21,643	21,341	21,604
Weighted average common shares outstanding subject to repurchase	( )	( )	( )	( )
Shares used in computing basic Net income (loss) per share	21,379	21,643	21,341	21,604
Shares used in computation diluted:				
Weighted average common shares outstanding	21,379	21,643	21,341	21,604
Dilutive effect of common shares outstanding subject to repurchase				
Dilutive effect of options outstanding				522
Shares used in computing diluted Net income (loss) per share	21,379	21,643	21,341	22,126
Net income (loss) per share basic	$ (0.66)	$ (0.01)	$ (0.99)	$ 0.08
Net income (loss) per share diluted	$ (0.66)	$ (0.01)	$ (0.99)	$ 0.08

The Company had securities outstanding which could potentially dilute basic earnings per share in the future; however, the incremental shares from the assumed exercise of these securities were excluded in the computation of diluted net income (loss) per share, as their effect would have been anti-dilutive. 1.7 million shares for each of the three and six month periods ended July 3, 2009 and 0.6 million and 0.8 million shares for the three months and six months ended June 27, 2008, respectively, have been excluded from the computation of diluted net loss per share because their inclusion would be anti-dilutive.

7. Related Party Transactions

The Company leases a facility from an entity controlled by one of the Company s board members. The Company incurred rent expense resulting from the lease of this facility of $67,000 and $134,000 for the three and six month periods ended July 3, 2009 and $65,000 and $128,000 for the six month periods ended March 28, 2008, respectively.

The spouse of one of the Company s executives is the sole owner of the Company s primary travel agency. The Company incurred fees for travel-related services, including the cost of airplane tickets, of $51,000 and $105,000 for the three and six months ended July 3, 2009 and $60,000 and $144,000 for the three and six month periods ended June 27, 2008, respectively.

8. Commitments and Contingencies

The Company had commitments to purchase inventory totaling approximately $7.2 million at July 3, 2009.

In September 2007, the Company entered into a facility lease agreement for approximately 104,000 square feet of office space in Hayward, California and began moving into the new facility towards the latter part of the second quarter of 2008. In lieu of a cash security deposit, the Company established an irrevocable standby letter of credit in the amount of $156,000 naming the landlord of the new facility as the beneficiary. Pursuant to the lease agreement, the Company received approximately $4.1 million in tenant improvement allowances and will receive incentives of approximately $1.2 million in rent abatements over the first two years of the lease. The Company has received approximately $1.1 million in incentives as of July 3, 2009. The operating lease term for the new facility commenced on April 1, 2008, and will continue through April 1, 2015, with minimum monthly lease payments beginning at $119,000 and escalating annually after the first two years. The Company s total future minimum lease payments over the term of the lease will be approximately $10.2 million.

From time to time, the Company are subject to various legal proceedings and claims, either asserted or unasserted, that arise in the ordinary course of business. Although the outcome of the various legal proceedings and claims cannot be predicted with certainty, the Company has not had a history of outcomes to date that have been material to the statement of operations and does not believe that any of these proceedings or other claims will have a material adverse effect on its consolidated financial condition or results of operations.

ITEM 2. Management s Discussion And Analysis of Financial Condition And Results Of Operations

This section and other parts of this quarterly report on Form 10-Q contain forward-looking statements regarding future events and our future results. Forward-looking statements can also be identified by words such as anticipates, expects, believes, plans, predicts, and similar terms. Forward-looking statements are not guarantees of future performance and the Company s actual results may differ significantly from the result discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed in Item 1A Risk Factors below. The following discussion should be read in conjunction with the consolidated financial statement and notes thereto included in Item 1 of this report. The Company assumes no obligation to revise or update any forward-looking statements for any reason, except as required by law.

Overview

We are a leading developer and supplier of critical subsystems, producing primarily gas delivery systems, chemical mechanical planarization (CMP) subsystems, chemical delivery modules, frame and top plate assemblies and process modules. We serve the semiconductor capital equipment, medical device, research, flat panel and solar industries. We develop, design, prototype, engineer, manufacture and test subsystems which are highly specialized and tailored to specific steps in the semiconductor manufacturing process as well as the manufacturing process in the other industries we serve.

The recent weakening global economy, severe tightening of the credit markets and turmoil in the financial markets are contributing to slowdowns in the markets we serve. Uncertainty regarding future growth in economies throughout the world have caused companies to reduce capital investment, the impact of which has been particularly severe in the semiconductor capital equipment industry. This economic uncertainty has led our customers to push out, cancel, or refrain from placing orders with us, which in turn has reduced our sales and negatively impacted our cash flow. However, our results in the second quarter of 2009 reflect some degree of stabilization in the semiconductor capital equipment industry.

Financial Highlights

Our operating results for the three and six months ended July 3, 2009, compared to the same periods in the prior year reflects a decrease in demand of our products as a result of an overall slowdown in the worldwide economy and semiconductor capital

equipment market. Sales for the three months ended July 3, 2009 were $23.3 million, a decrease of $44.1 million, or 65.5%, from the same quarter of 2008. Gross profit (loss) in the second quarter of 2009 decreased $8.4 million, or 111.4%, to $(0.9) million, or (3.7)% of sales, from $7.5 million, or 11.2% of sales, in the second quarter of 2008. Total operating expenses in the second quarter of 2009 decreased to $5.4 million, or 23.4% of sales, from $8.2 million, or 12.2% of sales, compared to the second quarter of 2008. We incurred a net loss during the second quarter of 2009 of $14.1 million compared to a net loss of $0.2 million for the same period in 2008 as a result of decreased sales and gross profits earned during the current quarter as well as a valuation allowance on our deferred tax assets of $7.0 million.

Results of Operations

For the periods indicated, the following table sets forth certain costs and expenses and other income items as a percentage of sales. The table and subsequent discussion should be read in conjunction with our condensed consolidated financial statements and notes thereto included elsewhere in our quarterly report.

	Three months ended		Six months ended	
	July 3, 2009	June 27, 2008	July 3, 2009	June 27, 2008
Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	103.7%	88.8%	108.2%	87.7%
Gross profit (loss)	(3.7)%	11.2%	(8.2)%	12.3%
Operating expenses:				
Research and development	3.2%	0.9%	3.6%	0.9%
Sales and marketing	5.0%	2.0%	4.8%	1.9%
General and administrative	15.1%	9.3%	19.4%	8.1%
Total operating expenses	23.4%	12.2%	27.9%	10.8%
Income (loss) from operations	(27.0)%	(1.0)%	(36.0)%	1.5%
Interest and other income (expense), net	(1.0)%	(0.4)%	(0.9)%	(0.4)%
Income (loss) before provision (benefit) for income taxes	(28.0)%	(1.4)%	(36.9)%	1.1%
Income tax provision (benefit)	32.5%	(0.9)%	9.2%	0.1%
Net income (loss)	(60.5)%	(0.4)%	(46.2)%	1.0%

Sales

Sales in the second quarter of 2009 decreased $44.1 million, or 65.5%, to $23.3 million from $67.4 million in the second quarter of 2008. The decrease in sales for the three month period reflects a decrease in semiconductor equipment demand as a result of the overall slowdown in the industry. We expect sales to increase in the third quarter of 2009.

Sales for the first six months of 2009 decreased $114.1 million, or 71.4%, to $45.7 million from $159.7 million for the first six months of 2008. The decrease in sales for the six month period reflects a decrease in semiconductor equipment demand as a result of the overall slowdown in the industry.

Gross Profit

Cost of goods sold consists primarily of purchased materials, labor and overhead, including depreciation related to certain capital assets associated with the design and manufacture of products sold. Gross profit (loss) for the three months ended July 3, 2009 decreased to ($0.9) million, or (3.7)% of sales, from a gross profit of $7.5 million, or 11.2% of sales, for the same period in 2008. Gross profit (loss) for the first six months of 2009 decreased $23.3 million to ($3.7) million, or (8.2)% of sales, from $19.6 million for the same period in 2008. Our gross margin for the three and six month periods ended July 3, 2009 decreased from the comparable period in 2008 due primarily to declining unit volume,

lower factory utilization and employee severance charges.