ULTRA CLEAN HOLDINGS INC
Form 10-Q/A
August 27, 2009
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-Q/A

**(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* | *(I.R.S. Employer* |
| *incorporation or organization)* | *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.

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## EXPLANATORY NOTE

This Amendment to the UltraClean Holdings, Inc. Quarterly Report on Form 10-Q for the quarter ended July 3, 2009 is being filed solely to correct the certifying officer to Exhibit 31.2. We are not amending any other part of the original Form 10-Q filed on August 10, 2009.

Except as described above, the remainder of the Form 10-Q is unchanged and does not reflect events occurring after the original filing of the Form 10-Q with the SEC on August 10, 2009.

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**ULTRA CLEAN HOLDINGS, INC.**

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**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.)

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**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.)

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**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.)

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**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%.

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*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.

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*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.

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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 |

*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.

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**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 |

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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.

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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.

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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.

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**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.

*Research and Development Expense*

Research and development expense consists primarily of activities related to new component testing and evaluation, test equipment and fixture development, product design, and other product development activities. Research and development expense for the second quarter of 2009 increased $0.1 million, or 23.4%, to $0.7 million, or 3.2% of sales, compared to $0.6 million, or 0.9% of sales in the same quarter in 2008. Research and development expense for the first six months of 2009 increased $0.3 million, or 19.6%, to $1.7 million, or 3.6% of sales, compared to $1.4 million, or 0.9% of sales for the same period in 2008. The increase in expense for both comparable periods of 2009 is primarily due to the reassignment of existing resources to new product development activities.

*Sales and Marketing Expense*

Sales and marketing expense consists primarily of salaries and commissions paid to our sales and service employees and other costs related to the sales of our products. Sales and marketing expense for the second quarter of 2009 was $1.2 million, or 5.0% of sales, compared to $1.3 million, or 2.0% of sales, in the same quarter of 2008. Sales and marketing expense for the first six months of 2009 was $2.2 million, or 4.8% of sales, compared to $3.0 million, or 1.9% of sales, for the same period in 2008. The increase in percent of sales for both the three and six month periods of 2009 is due to a decrease in sales during second quarter and first six months of 2009 compare to the respective periods in 2008. The decrease in dollars is due to primarily to reduced payroll and related benefit costs due to decreases in headcount and salary reductions as well as a decrease in depreciation expense associated with the impairment of long-term assets the Company took in the fourth quarter of fiscal 2008.

*General and Administrative Expense*

General and administrative expense consists primarily of salaries and overhead associated with our administrative staff and professional fees. General and administrative expense decreased approximately $2.7 million, or 43.7% in the second quarter of 2009 to $3.5 million, or 15.1% of sales, compared with $6.3 million, or 9.3% of sales, in the same quarter of 2008. General and administrative expense decreased approximately $4.0 million, or 31.2% during the first six months of 2009 to $8.9 million, or 19.4% of sales, compared to $12.9 million, or 8.1% of sales, for the same period of 2008. The increase in percent of sales for both the three and six month periods of 2009 is due to a decrease in sales during the second quarter and first six months of 2009 compared to the respective periods in 2008. The decrease in dollars is due to primarily to reduced payroll and related benefit costs due to decreases in headcount and salary reductions as well as a decrease in depreciation expense associated with the impairment of long-term assets the Company took in the fourth quarter of fiscal 2008.

*Interest and Other Income (Expense), net*

Interest and other income (expense), net consists primarily of interest expense on the Company s debt, and for the second quarter and first six months of 2009 was $228,000 and $423,000, respectively, compared to $246,000 and $590,000 for the respective periods of 2008. As a result of a new loan agreement with our credit facility in the first quarter of 2009, the average interest rates on our debt have increased slightly during the current quarter compared to the prior quarter and are relative to interest rates applied on our debt facilities during the same period in the prior year. Interest expense was lower for the three and six months ended July 3, 2009 compared to the same periods of 2008 due to primarily to lower respective average debt balances.

*Income Tax Provision*

Our tax provision (benefit) as a percentage of pre-tax income for the first six months of 2009 was 25.2% compared to (17.3%) for the year ended December 28, 2008. The change in rate from the prior year reflects, primarily a tax valuation allowance, a change in the geographic mix of worldwide earnings and financial results for 2009 compared with the fiscal year 2008. Excluding the tax valuation allowance, our current year tax rate is (34%) compared to the federal statutory rate of (35%), primarily as a result of state and foreign taxes.

Based on our recent historical operating results and outlook for 2009, we have determined that it is more likely than not that our deferred tax assets will not be realized. Therefore, we established a tax valuation allowance against our deferred tax assets in the second quarter of 2009. Prior to the second quarter of 2009, management considered a tax planning strategy and concluded that the Company has the ability to implement the strategy and intended 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 and a tax valuation allowance was provided against our deferred tax assets. These deferred tax assets are primarily attributable to net operating losses accumulated in the prior year and in the first quarter of 2009. In establishing this valuation allowance we are reducing our deferred tax asset value of $7.0 million to zero.

For income tax filing and cash payment purposes, we do not expect any increase in the level of cash payments, as we continue to benefit from our net operating losses.

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**Liquidity and Capital Resources**

We have funded our operations through financing activities and operations and we require capital principally to fund our working capital needs, satisfy our debt obligations, maintain our equipment and purchase new capital equipment. As of July 3, 2009, we had cash of $30.2 million compared to $29.6 million as of January 2, 2009.

For the quarter ended July 3, 2009 we generated cash from operating activities of $3.1 million compared to $7.9 million of cash generated in operating activities for the same period in the prior year. Operating cash flows were favorably impacted by net non-cash activity of $10.2 million, including deferred income taxes of $7.4 million, depreciation and amortization of $1.3 million and stock-based compensation of $1.6 million, decreases in inventory, accounts receivable and prepaid and other of $7.8 million, $3.5 million and $3.8 million, respectively, and were unfavorably impacted by an decrease in accrued compensation and related benefits of $1.0 million.

Net cash used in investing activities were $0.2 million for the first six months of 2009, representing a decrease of $7.9 million when compared to the same period in 2008, due primarily to a reduction in capital spending on our new facility in Hayward, CA.

Net cash used in financing activities for the first six months of fiscal 2009 increased $1.7 million to $2.4 million from $0.7 million in the same quarter of the prior year. Our use of cash in financing activities for the first six months of 2009 was primarily due to payments on short-term and long-term debt of $4.7 million and $3.2 million, respectively, offset by proceeds from bank borrowings of $5.5 million.

During fiscal 2008 and into the second quarter of fiscal 2009, we took steps to reduce our operating costs in line with our revenues in the form of factory shutdowns, reductions in headcount and other cost-cutting measures. We will continue to monitor the state of the current economy and its impact on our business and will make additional cost reductions as deemed necessary to align revenues and expenses and ensure we maintain sufficient funds to effectively run the business. We anticipate that our existing cash balances and operating cash flow, together with available borrowings under our credit facility as amended on February 4, 2009 (see *Borrowing Arrangements* above) will be sufficient to meet our working capital requirements and technology development projects for at least the next twelve months. The adequacy of these resources to meet our liquidity needs beyond that period will depend on our growth, the state of the worldwide economy, the cyclical expansion or contraction of the semiconductor capital equipment industry and the other industries we serve and capital expenditures required to meet possible increased demand for our products.

**Contractual Obligations and Contingent Liabilities and Commitments**

Other than operating leases for certain equipment and facilities, we have no significant off-balance sheet transactions, unconditional purchase obligations or similar instruments and, other than with respect to the revolving credit facility described above, are not a guarantor of any other entities debt or other financial obligations.

The following table summarizes our future minimum lease payments and principal payments under debt obligations, in thousands, as of July 3, 2009. Of the $13.5 million in operating leases, $180,000, which is net of estimated sublease income of $130,000, is included in other accrued liabilities, as of July 3, 2009.

| | 2009 | 2010 | 2011 | 2012 | 2013 | Thereafter | Total |
|---|---|---|---|---|---|---|---|
| Capital lease | $ 7 | $ 6 | $ 6 | $ 6 | $ 7 | $ 3 | $ 35 |
| Operating lease (1) | 1,691 | 2,985 | 2,366 | 2,200 | 1,920 | 2,333 | 13,495 |
| Borrowing arrangements | 976 | 2,008 | 1,443 | 11,649 | | | 16,076 |
| Total (2) | $ 2,674 | $ 4,999 | $ 3,815 | $ 13,855 | $ 1,927 | $ 2,336 | $ 29,606 |

(1) Operating lease expense reflects (a) the lease for our headquarters facility in Hayward, California; (b) the lease for a manufacturing facility in Portland, Oregon that expires on October 31, 2010 net of estimated sublease rental income; (c) the leases for manufacturing facilities in South San Francisco that expire in 2009 and 2010; (d) the leases for manufacturing facilities in Austin, Texas that expire in 2010 and 2011. We have options to renew certain of the leases in South San Francisco, which we expect to exercise.

(2)

As a result of the implementation of FIN 48, we have recorded an additional tax liability of $221,000 to offset the recognition of previously recorded excess tax benefits. Because of the uncertainty surrounding the future payment of these liabilities, the amounts have been excluded from the table above.

**Critical Accounting Policies, Significant Judgments and Estimates**

Our condensed consolidated financial statements have been prepared in accordance with GAAP, which requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure at the date of our financial statements. Estimates and judgments are reviewed on an on-going basis, including those related to sales, inventories, intangible assets, stock compensation and income taxes. The estimates and judgments are based on historical experience and on various other factors that we believe to be reasonable under the circumstances, the results of which form the basis of the judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates. We consider certain accounting policies related to the purchase accounting, revenue recognition, inventory valuation, accounting for income taxes, valuation of intangible assets and goodwill and equity incentives to employees to be critical policies due to the estimates and judgments involved in each. Our significant accounting policies and critical estimates are disclosed in our 2008 Annual Report on Form 10-K as filed with the SEC on March 19, 2009. No material changes to our significant accounting policies and critical estimates have occurred subsequent to January 3, 2009.

**Accounting for Income Taxes**

The determination of our tax provision is subject to judgments and estimates. FAS No.109, *Accounting for Income Taxes* ( FAS 109 ) states that a deferred tax asset should be reduced by a valuation allowance if, based on the weight of all available evidence, it is more likely than not that some portion or all of the deferred tax asset will not be realized. The valuation allowance should be sufficient to reduce the deferred tax asset to the amount that is more likely than not to be realized. In determining whether the Company s deferred tax asset is realizable, the Company weighed all available evidence, including both positive and negative evidence. The realization of deferred tax assets depends upon the existence of sufficient taxable income of the same character during the carryback or carryforward period. The Company has considered all sources of taxable income available to realize the deferred tax asset, including the future reversal of existing temporary differences, future taxable income exclusive of reversing temporary differences and carry forwards, taxable income in carry back years and tax-planning strategies.

Based on the Company s recent historical operating results and its outlook for 2009, we have determined it is more likely than not that our deferred tax assets will not be realized. As such, we recorded a full deferred tax valuation allowance reducing our deferred tax asset value of $7.0 million to zero. These deferred tax assets are mostly attributable to net operating losses accumulated in the prior year and in the first quarter of 2009. Prior to the second quarter of 2009, the future realization of these deferred tax assets was more likely than not and no valuation allowance was required as management considered a tax planning strategy and concluded that the Company has the ability to implement the strategy and intended 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.

**Recently Issued Accounting Standards**

See *Recently Issued Accounting Standards* in Note 1 of Notes to Condensed Consolidated Financial Statements.

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

Market risk represents the risk of changes in value of financial instruments caused by fluctuations in interest rates and foreign exchange rates.

***Foreign Exchange Rates***

Currently, a significant majority of our sales and arrangements with third-party suppliers provide for pricing and payment in U.S. dollars, and, therefore, are not subject to material exchange rate fluctuations. Therefore, we do not expect foreign currency exchange rate fluctuations to have a material effect on our results of operations. Increases in the value of the U.S. dollar relative to other currencies would make our products more expensive to our international customers, which could negatively impact our ability to compete. Conversely, decreases in the value of the U.S. dollar relative to other currencies could result in our suppliers raising their prices in order to continue doing business with us.

***Interest Rates***

Our interest rate risk relates primarily to our third party debt which totals $16.1 million as of July 3, 2009, and carries interest rates pegged to the LIBOR and PRIME rates. An immediate increase in interest rates of 100 basis points would increase our interest expense by approximately $40,000 per quarter. This would be partially offset by increased interest income on our invested cash. Conversely, an immediate decline of 100 basis points in interest rates would decrease our interest expense by approximately $40,000 per quarter. This would be partially offset by decreased interest income on our invested cash.

**ITEM 4. Controls and Procedures**

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act ), management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that due to the material weakness described below, we did not have effective disclosure controls and procedures as of the end of the period covered by this quarterly report on Form 10-Q. The following material weakness was identified:

- The Company did not maintain sufficient and qualified resources with the proper training and experience related to year-end physical inventory count procedures at our new centralized manufacturing facility in Hayward, California and in the computation of inventory reserves with respect to the Company s accounting policies and procedures in accordance with accounting principles generally accepted in the United States of America.

This material weakness was previously reported in our 2008 Annual Report on Form 10-K filed with the SEC on March 19, 2009. The Company is in the process of remediating this material weakness and is currently testing the results of its remediation plan. We expect this material weakness to be remediated by the end of the third quarter of 2009.

As required by Rule 13a-15(d), management, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. In response to the material weakness described above, during the period covered by this quarterly report on Form 10-Q, we made the following changes to our internal control over financial reporting:

- During the first quarter of 2009 we hired a new Director of Materials in our Hayward location to oversee all areas of our inventory operations, including cycle counting and physical inventory count procedures.

- We revised certain procedures to ensure the accuracy of our inventory reserve calculation.

Any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

## PART II. OTHER INFORMATION

**ITEM 1. Legal Proceedings**

From time to time, we are subject to various legal proceedings and claims, either asserted or unasserted, that arise in the ordinary course of business.

**ITEM 1A. Risk Factors**

***We are exposed to risks associated with the ongoing financial crisis and weakening global economy.***

The recent weakening global economy, severe tightening of the credit markets and turmoil in the financial markets are contributing to slowdowns in the industries in which we operate. Reduced growth and uncertainty regarding future growth in economies throughout the world have caused companies to reduce capital investment and may in the future cause further reduction of such investments. These reductions have often been particularly severe in the semiconductor capital equipment industry. Economic uncertainty has led to historically low consumer confidence levels and has caused and may in the future cause our customers to push out, cancel, or refrain from placing orders with us, which in turn would further reduce our sales and negatively impact our cash flow. Our sales were $23.3 million in the second quarter of 2009 and $266.9 million for fiscal year 2008 compared to $67.4 million in the second quarter of fiscal 2008 and $403.8 million for fiscal year 2007. We incurred a net loss of $14.1 million during the second quarter of fiscal 2009, which included a deferred tax asset valuation allowance of $8.9 million, and $52.4 million, which included a charge for impairment of goodwill and other long-lived assets of $55.1 million, for the year ended January 2, 2009, and we expect to incur additional losses in the future. While there can be no assurance as to when the current economic slowdown will

end, a period of recovery may nonetheless result in significant fluctuations in customer orders. In the recent period of declining

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demand, there is a greater risk that we acquire inventory in excess of levels demanded by our customers, which could cause us to incur excess or obsolete inventory charges. Also, as a result of the weakening global economy, certain of our suppliers may be forced out of business, which would require us to either procure products from high-cost suppliers, or if no additional suppliers exist, to reconfigure the design and manufacture of our products, and we may be unable to fulfill some customer orders. Furthermore, the tightening of credit in financial markets may delay or prevent our customers from securing funding adequate to operate their businesses and purchase our products.

Furthermore, the equity and credit markets have been experiencing a high level of volatility and disruption at unprecedented levels. The market for new equity and debt financing is limited and in some cases not available at all. There is also uncertainty that lenders will satisfy their commitments under existing facilities. If current levels of market disruption and volatility continue or worsen, we may not be able to draw upon our revolving credit facility, incur additional debt or raise new equity in the event we need to do so.

These conditions and uncertainty about future economic conditions make it challenging for us to forecast our operating results, make business decisions, and identify the risks that may affect our business, financial condition and results of operations. We expect business conditions to remain difficult, and we have implemented cost reduction programs aimed at aligning our ongoing operating costs with our currently expected revenues over the near term. These cost management initiatives include reductions to headcount and reduced spending. If we are not able to timely and appropriately adapt to changes resulting from the difficult macroeconomic environment, our business, financial condition and results of operations could be adversely affected.

***The highly volatile nature of the industries we serve could harm our operating results.***

Our business and operating results depend in significant part upon capital expenditures by manufacturers of semiconductors, flat panel displays, solar and medical devices, which in turn depend upon the current and anticipated market demand for such products. Historically, the industries we serve (in particular the semiconductor industry) have been highly cyclical, with recurring periods of over-supply of products that have had a severe negative effect on the demand for capital equipment used to manufacture such products. We have experienced and anticipate that we will continue to experience significant fluctuations in customer orders for our products through such cycles. Slowdowns in the industries we serve have had, and future slowdowns may also have, a material adverse effect on our operating results. During periods of decreasing demand for our products, we must be able to appropriately align our cost structure with prevailing market conditions, effectively manage our supply chain and motivate and retain employees. During periods of increasing demand, we must increase manufacturing capacity and inventory to meet customer demands, effectively manage our supply chain and attract, retain and motivate a sufficient number of qualified employees. If we are not able to timely and appropriately adapt to the changes in our business environment, our results of operations will be harmed. Also, the cyclical and volatile nature of the industries we serve make future revenues, results of operations and net cash flows difficult to estimate.

***We rely on a small number of customers for a significant portion of our sales, and any impairment of our relationships with these customers would adversely affect our business.***

A relatively small number of OEM customers have historically accounted for a significant portion of our sales, and we expect this trend to continue. Collectively, Applied Materials, Inc., FEI Company, Intuitive Surgical, Inc., and Lam Research Corporation accounted for 91.3% of our sales in the second quarter of 2009. Three of these four 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 companies accounted for 70.8% of the combined sales for the six months ended June 27, 2008. Because of the small number of OEMs in the markets we serve, most of which are already our customers, it would be difficult to replace lost revenue resulting from the loss of, or the reduction, cancellation or delay in purchase orders by any one of these customers. Our customer contracts generally do not require them to place any orders with us. Consolidation among our customers, or a decision by any one or more of our customers to outsource all or most manufacturing and assembly work to a single equipment manufacturer, may further concentrate our business in a limited number of customers and expose us to increased risks relating to dependence on an even smaller number of customers.

In addition, by virtue of our customers size and the significant portion of revenue that we derive from them, they are able to exert significant influence and pricing pressure in the negotiation of our commercial agreements and the conduct of our business with them. We may also be asked to accommodate customer requests that extend beyond the express terms of our agreements in order to maintain our relationships with our customers. If we are unable to retain and expand our business with these customers on favorable terms, our business and operating results will be adversely affected.

We have had to qualify, and are required to maintain our status, as a supplier for each of our customers. This is a lengthy process that involves the inspection and approval by a customer of our engineering, documentation, manufacturing and quality control

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procedures before that customer will place volume orders. Our ability to lessen the adverse effect of any loss of, or reduction in sales to, an existing customer through the rapid addition of one or more new customers is minimal because of these qualification requirements. Consequently, our business, operating results and financial condition would be adversely affected by the loss of, or any reduction in orders by, any of our significant customers.

***Our quarterly revenue and operating results fluctuate significantly from period to period, and this may cause volatility in our common stock price.***

Our quarterly revenue and operating results have fluctuated significantly in the past, and we expect them to continue to fluctuate in the future for a variety of reasons which may include:

- demand for and market acceptance of our products as a result of the cyclical nature of the industries we serve or otherwise, often resulting in reduced sales during industry downturns and increased sales during periods of industry recovery;
- Overall economic conditions;
- changes in the timing and size of orders by our customers;
- cancellations and postponements of previously placed orders;
- pricing pressure from either our competitors or our customers, resulting in the reduction of our product prices;
- disruptions or delays in the manufacturing of our products or in the supply of components or raw materials that are incorporated into or used to manufacture our products, thereby causing us to delay the shipment of products;
- decreased margins for several or more quarters following the introduction of new products, especially as we introduce new subsystems;
- delays in ramp-up in production, low yields or other problems experienced at our manufacturing facilities in China;
- changes in design-to-delivery cycle times;
- inability to reduce our costs quickly in step with reductions in our prices or in response to decreased demand for our products;
- changes in our mix of products sold;
- write-offs of excess or obsolete inventory;

- one-time expenses or charges associated with failed acquisition negotiations or completed acquisitions;

- announcements by our competitors of new products, services or technological innovations, which may, among other things, render our products less competitive; and

- geographic mix of worldwide earnings.

As a result of the foregoing, we believe that quarter-to-quarter comparisons of our revenue and operating results may not be meaningful and that these comparisons may not be an accurate indicator of our future performance. Changes in the timing or terms of a small number of transactions could disproportionately affect our operating results in any particular quarter. Moreover, our operating results in one or more future quarters may fail to meet the expectations of securities analysts or investors. If this occurs, we would expect to experience an immediate and significant decline in the trading price of our common stock.

***We have established, and as markets will allow, intend to expand our operations in China, which exposes us to risks associated with operating in a foreign country.***

We intend to expand, as markets will allow, our operations in China. Our total assets in China at July 3, 2009 were $19.0 million.

We are exposed to political, economic, legal and other risks associated with operating in China, including:

- foreign currency exchange fluctuations;

- political, civil and economic instability;
- tariffs and other barriers;
- timing and availability of export licenses;
- disruptions to our and our customers operations due to the outbreak of communicable diseases, such as SARS and avian flu;
- disruptions in operations due to the weakness of China s domestic infrastructure, including transportation and energy;
- difficulties in developing relationships with local suppliers;
- difficulties in attracting new international customers;
- difficulties in accounts receivable collections;
- difficulties in staffing and managing a distant international subsidiary and branch operations;
- the burden of complying with foreign and international laws and treaties;
- difficulty in transferring funds to other geographic locations; and
- potentially adverse tax consequences.

Our operations in China also subject us to U.S. laws governing the export of equipment. These laws are complex and require us to obtain clearances for the export to China of certain equipment. We may fail to comply with these laws and regulations, which could require us to cease use of certain equipment and expose us to fines or penalties.

Over the past several years the Chinese government has pursued economic reform policies, including the encouragement of private economic activity and greater economic decentralization. The Chinese government may not continue these policies or may significantly alter them to our detriment from time to time without notice. Changes in laws and regulations or their interpretation, the imposition of confiscatory taxation policies, new restrictions on currency conversion or limitations on sources of supply could materially and adversely affect our Chinese operations, which could result in the partial or total loss of our investment in that country and materially and adversely affect our future operating results.

***Third parties have claimed and may in the future claim we are infringing their intellectual property, which could subject us to litigation or licensing expenses, and we may be prevented from selling our products if any such claims prove successful.***

We have in the past and may in the future receive claims that our products, processes or technologies infringe the patents or other proprietary rights of third parties. In addition, we may be unaware of intellectual property rights of others that may be applicable to our products. Any litigation regarding our patents or other intellectual property could be costly and time-consuming and divert our management and key personnel from our business operations, any of which could have a material adverse effect on our business and results of operations. The complexity of the technology involved in our products and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property

infringement may also require us to enter into costly license agreements. However, we may not be able to obtain licenses on terms acceptable to us, or at all. We also may be subject to significant damages or injunctions against the development, manufacture and sale of certain of our products if any such claims prove successful.

***We are subject to order and shipment uncertainties and any significant reductions, cancellations or delays in customer orders could cause our revenue to decline and our operating results to suffer.***

Our revenue is difficult to forecast because we generally do not have a material backlog of unfilled orders and because of the short time frame within which we are often required to design, produce and deliver products to our customers. Most of our revenue in any quarter depends on customer orders for our products that we receive and fulfill in the same quarter. We do not have long-term purchase orders or contracts that contain minimum purchase commitments from our customers. Instead, we receive non-binding forecasts of the future volume of orders from our customers. Occasionally, we order and build component inventory in advance of the

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receipt of actual customer orders. Customers may cancel order forecasts, change production quantities from forecasted volumes or delay production for reasons beyond our control. Furthermore, reductions, cancellations or delays in customer order forecasts usually occur without penalty to, or compensation from, the customer. Reductions, cancellations or delays in forecasted orders could cause us to hold inventory longer than anticipated, which could reduce our gross profit, restrict our ability to fund our operations and cause us to incur unanticipated reductions or delays in revenue. If we do not obtain orders as we anticipate, we could have excess component inventory for a specific product that we would not be able to sell to another customer, likely resulting in inventory write-offs, which could have a material adverse effect on our business, financial condition and operating results. In addition, because many of our costs are fixed in the short term, we could experience deterioration in our gross profit when our production volumes decline.

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***The manufacturing of our products is highly complex, and if we are not able to manage our manufacturing and procurement process effectively, our business and operating results will suffer.***

The manufacturing of our products is a highly complex process that involves the integration of multiple components and requires effective management of our supply chain while meeting our customers design-to-delivery cycle time requirements. Through the course of the manufacturing process, our customers may modify design and system configurations in response to changes in their own customers requirements. In order to rapidly respond to these modifications and deliver our products to our customers in a timely manner, we must effectively manage our manufacturing and procurement process. If we fail to manage this process effectively, we risk losing customers and damaging our reputation. In addition, if we acquire inventory in excess of demand or that does not meet customer specifications, we could incur excess or obsolete inventory charges. These risks are even greater during an economic downturn as we are currently experiencing and as we continue to expand our business beyond gas delivery systems into new subsystems. In this economic downturn, certain of our suppliers may be forced out of business, which would require us to either procure product from higher-cost suppliers or, if no additional suppliers exist, reconfigure the design and manufacture of our products. This could limit our growth and have a material adverse effect on our business, financial condition and operating results.

***OEMs may not continue to outsource other critical subsystems, which would adversely impact our operating results.***

The success of our business depends on OEMs continuing to outsource the manufacturing of critical subsystems. Most of the largest OEMs have already outsourced production of a significant portion of their critical subsystems. If OEMs do not continue to outsource critical subsystems for their capital equipment, our revenue would be significantly reduced, which would have a material adverse effect on our business, financial condition and operating results. In addition, if we are unable to obtain additional business from OEMs, even if they continue to outsource their production of critical subsystems, our business, financial condition and operating results could be adversely affected.

***If our new products are not accepted by OEMs or if we are unable to maintain historical margins on our new products, our operating results would be adversely impacted.***

We design, develop and market critical subsystems to OEMs. Sales of new products are expected to make up an increasing part of our total revenue. The introduction of new products is inherently risky because it is difficult to foresee the adoption of new standards, coordinate our technical personnel and strategic relationships and win acceptance of new products by OEMs. We may not be able to recoup design and development expenditures if our new products are not accepted by OEMs. Newly introduced products typically carry lower gross margins for several or more quarters following their introduction. If any of our new subsystems is not successful in the market, or if we are unable to obtain gross margins on new products that are similar to the gross margins we have historically achieved, our business, operating results and financial condition could be adversely affected.

***We may not be able to integrate efficiently the operations of past and future acquired businesses.***

We have made, and may in the future consider making, additional acquisitions of, or significant investments in, businesses that offer complementary products, services, technologies or market access. For example, we acquired Sieger Engineering, Inc. in June 2006. If we are to realize the anticipated benefits of past and future acquisitions or investments, the operations of these companies must be integrated and combined efficiently with our own. The process of integrating supply and distribution channels, computer and accounting systems, and other aspects of operations, while managing a larger entity, have and will present a significant challenge to our management. In addition, it is not certain that we will be able to incorporate different financial and reporting controls, processes, systems and technologies into our existing business environment. The difficulties of integration may increase because of the necessity of combining personnel with varied business backgrounds and combining different corporate cultures and objectives. We may assume substantial debt and incur substantial costs associated with these activities and we may suffer other material adverse effects from these integration efforts which could materially reduce our earnings, even over the long-term. We may not succeed with the integration process and we may not fully realize the anticipated benefits of the business combinations. The dedication of management resources to such integration or divestitures may detract attention from the day-to-day business, and we may need to hire additional management personnel to manage our acquisitions successfully.

In addition, we frequently evaluate acquisitions of, or significant investments in, complementary companies, assets, businesses and technologies. Even if an acquisition or other investment is not completed, we may incur significant management time and effort and financial cost in evaluating such acquisition or investment, which has in the past had, and could in the future have, an adverse effect on our results of operations. Furthermore, due to the limited liquidity in the credit market, the financing of any such acquisition may be difficult to obtain, and the terms of such financing may be less favorable.

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***Our business is largely dependent on the know-how of our employees, and we generally do not have a protected intellectual property position.***

Our business is largely dependent upon our design, engineering, manufacturing and testing know-how. We rely on a combination of trade secrets and contractual confidentiality provisions and, to a much lesser extent, patents, copyrights and trademarks to protect our proprietary rights. Accordingly, our intellectual property position is more vulnerable than it would be if it were protected by patents. If we fail to protect our proprietary rights successfully, our competitive position could suffer, which could harm our operating results. We may be required to spend significant resources to monitor and protect our proprietary rights, and, in the event we do not detect infringement of our proprietary rights, we may lose our competitive position in the market if any such infringement occurs. In addition, competitors may design around our technology or develop competing technologies and know-how.

***If we do not keep pace with developments in the industries we serve and with technological innovation generally, our products may not be competitive.***

Rapid technological innovation in semiconductor, flat panel displays, solar and medical device manufacturing requires capital equipment providers to anticipate and respond quickly to evolving customer requirements and could render our current product offerings and technology obsolete. Technological innovations are inherently complex. We must devote resources to technology development in order to keep pace with such rapidly evolving technologies. We believe that our future success will depend upon our ability to design, engineer and manufacture products that meet the changing needs of our customers. This requires that we successfully anticipate and respond to technological changes in design, engineering and manufacturing processes in a cost-effective and timely manner. If we are unable to integrate new technical specifications into competitive product designs, develop the technical capabilities necessary to manufacture new products or make necessary modifications or enhancements to existing products, our business prospects could be harmed.

The timely development of new or enhanced products is a complex and uncertain process which requires that we:

- design innovative and performance-enhancing features that differentiate our products from those of our competitors;
- identify emerging technological trends in the industries we serve, including new standards for our products;
- accurately identify and design new products to meet market needs;
- collaborate with OEMs to design and develop products on a timely and cost-effective basis;
- ramp-up production of new products, especially new subsystems, in a timely manner and with acceptable yields;
- successfully manage development production cycles; and
- respond effectively to technological changes or product announcements by others.

***The industries in which we participate are highly competitive and rapidly evolving, and if we are unable to compete effectively, our operating results would be harmed.***

Although we have not faced competition in the past from the largest subsystem and component manufacturers in the industries we serve, these suppliers could compete with us in the future. Increased competition has in the past resulted, and could in the future result, in price reductions, reduced gross margins or loss of market share, any of which would harm our operating results. We are subject to pricing pressure as we attempt to increase market share with our existing customers. Competitors may introduce new products for the markets currently served by our products. These products may have better performance, lower prices and achieve broader market acceptance than our products. Further, OEMs typically

own the design rights to their products and may provide these designs to other subsystem manufacturers. If our competitors obtain proprietary rights to these designs such that we are unable to obtain the designs necessary to manufacture products for our OEM customers, our business, financial condition and operating results could be adversely affected.

Our competitors may have greater financial, technical, manufacturing and marketing resources than we do. As a result, they may be able to respond more quickly to new or emerging technologies and changes in customer requirements, devote greater resources to the development, promotion, sale and support of their products, and reduce prices to increase market share. Moreover, there may be merger and acquisition activity among our competitors and potential competitors that may provide our competitors and potential competitors an advantage over us by enabling them to expand their product offerings and service capabilities to meet a broader range of customer needs. Further, if one of our customers develops or acquires the internal capability to develop and produce critical subsystems that we produce, the loss of that customer could have a material adverse effect on our business, financial condition and operating results. The introduction of new technologies and new market entrants may also increase competitive pressures.

***We must achieve design wins to retain our existing customers and to obtain new customers.***

New capital equipment typically has a lifespan of several years, and OEMs frequently specify which systems, subsystems, components and instruments are to be used in their equipment. Once a specific system, subsystem, component or instrument is incorporated into a piece of capital equipment, it will likely continue to be incorporated into that piece of equipment for at least several months before the OEM switches to the product of another supplier.

Accordingly, it is important that our products are designed into the new semiconductor, solar, flat panel and medical device capital equipment of OEMs, which we refer to as a design win, in order to retain our competitive position with existing customers and to obtain new customers.

We incur technology development and sales expenses with no assurance that our products will ultimately be designed into an OEM s capital equipment. Further, developing new customer relationships, as well as increasing our market share at existing customers, requires a substantial investment of our sales, engineering and management resources without any assurance from prospective customers that they will place significant orders. We believe that OEMs often select their suppliers and place orders based on long-term relationships. Accordingly, we may have difficulty achieving design wins from OEMs that are not currently our customers. Our operating results and potential growth could be adversely affected if we fail to achieve design wins with leading OEMs.

***We may not be able to respond quickly enough to increases in demand for our products.***

Demand shifts in the industries we serve are rapid and difficult to predict, and we may not be able to respond quickly enough to an increase in demand. Our ability to increase sales of our products depends, in part, upon our ability to:

- mobilize our supply chain in order to maintain component and raw material supply;
- optimize the use of our design, engineering and manufacturing capacity in a timely manner;
- deliver our products to our customers in a timely fashion;
- expand, if necessary, our manufacturing capacity; and
- maintain our product quality as we increase production.

If we are unable to respond to rapid increases in demand for our products on a timely basis or to manage any corresponding expansion of our manufacturing capacity effectively, our customers could increase their purchases from our competitors, which would adversely affect our business.

***Our dependence on our suppliers may prevent us from delivering an acceptable product on a timely basis.***

We rely on both single-source and sole-source suppliers, some of whom are relatively small, for many of the components we use in our products. In addition, our customers often specify components of particular suppliers that we must incorporate into our products. Our suppliers are under

no obligation to provide us with components. As a result, the loss of or failure to perform by any of these providers could adversely affect our business and operating results. The risk of such a loss is particularly high as a result of the current economic downturn, as many of our suppliers have announced poor operating results and have limited access to capital. In addition, the manufacturing of certain components and subsystems is an extremely complex process. Therefore, if a supplier were unable to provide the volume of components we require on a timely basis and at acceptable prices, we would have to identify and

qualify replacements from alternative sources of supply. The process of qualifying new suppliers for these complex components is lengthy and could delay our production, which would adversely affect our business, operating results and financial condition. We may also experience difficulty in obtaining sufficient supplies of components and raw materials in times of significant growth in our business. For example, we have in the past experienced shortages in supplies of various components, such as mass flow controllers, valves and regulators, and certain prefabricated parts, such as sheet metal enclosures, used in the manufacture of our products. In addition, one of our competitors manufactures mass flow controllers that may be specified by one or more of our customers. If we are unable to obtain these particular mass flow controllers from our competitor or convince a customer to select alternative mass flow controllers, we may be unable to meet that customer s requirements, which could result in a loss of market share.

***Defects in our products could damage our reputation, decrease market acceptance of our products, cause the unintended release of hazardous materials and result in potentially costly litigation.***

A number of factors, including design flaws, material and component failures, contamination in the manufacturing environment, impurities in the materials used and unknown sensitivities to process conditions, such as temperature and humidity, as well as equipment failures, may cause our products to contain undetected errors or defects. Problems with our products may:

- cause delays in product introductions and shipments;
- result in increased costs and diversion of development resources;
- cause us to incur increased charges due to unusable inventory;
- require design modifications;
- decrease market acceptance of, or customer satisfaction with, our products, which could result in decreased sales and product returns; or
- result in lower yields for semiconductor manufacturers.

If any of our products contain defects or have reliability, quality or compatibility problems, our reputation might be damaged and customers might be reluctant to buy our products. We may also face a higher rate of product defects as we increase our production levels. Product defects could result in the loss of existing customers or impair our ability to attract new customers. In addition, we may not find defects or failures in our products until after they are installed in a manufacturer s fabrication facility. We may have to invest significant capital and other resources to correct these problems. Our current or potential customers also might seek to recover from us any losses resulting from defects or failures in our products. Hazardous materials flow through and are controlled by our products and an unintended release of these materials could result in serious injury or death. Liability claims could require us to spend significant time and money in litigation or pay significant damages.

***We have outstanding indebtedness; the restrictive covenants under our debt agreements may limit our ability to expand or pursue our business strategy; if we are forced to prepay some or all of this indebtedness our financial position would be severely and adversely affected.***

We have outstanding indebtedness. At the end of our second quarter of fiscal 2009, our long-term debt was $14.1 million and our short-term debt was $2.0 million, for an aggregate total of $16.1 million. Our loan agreement, as amended on February 4, 2009, requires compliance with certain financial covenants, including maintenance of a minimum monthly tangible net worth and a minimum monthly liquidity coverage ratio. The covenants contained in our line of credit with the bank also restrict our ability to take certain actions, including our ability to:

- incur additional indebtedness;

pay dividends and make distributions in respect of our capital stock;

redeem capital stock;

make investments or other restricted payments outside the ordinary course of business;

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- engage in transactions with stockholders and affiliates;
- create liens;
- sell or otherwise dispose of assets;
- make payments on our other debt, other than in the ordinary course; and
- engage in certain mergers and acquisitions.

We are currently in compliance with the financial and reporting covenants in our loan agreement. We cannot assure you that we will meet these financial covenants in subsequent periods. If we are unable to meet any covenants, we cannot assure you that the bank will grant waivers or amend the covenants, or that the bank will not terminate the agreement, preclude further borrowings or require us to immediately repay any outstanding borrowings. As long as our indebtedness remains outstanding, the restrictive covenants could impair our ability to expand or pursue our business strategies or obtain additional funding. Forced prepayment of some or all of our indebtedness would reduce our available cash balances and have an adverse impact on our operating and financial performance.

***We may not be able to fund our future capital requirements from our operations, and financing from other sources may not be available on favorable terms or at all.***

We made capital expenditures of $9.4 million during fiscal 2008, of which $7.7 million related to improvements to our new manufacturing facility in Hayward, California and $1.7 million related to the development of our manufacturing facilities in China. The amount of our future capital requirements will depend on many factors, including:

- general worldwide financial market conditions;
- the cost required to ensure access to adequate manufacturing capacity;
- the timing and extent of spending to support product development efforts;
- the timing of introductions of new products and enhancements to existing products;
- changing manufacturing capabilities to meet new customer requirements; and
- market acceptance of our products.

Although we amended our loan agreement and extended the maturity of our credit facility through January 29, 2012, we may need to raise additional funds through public or private equity or debt financing if our current cash and cash flow from operations are insufficient to fund our future activities. Due to very limited liquidity in the credit market, we may not be able to obtain additional debt financing when and if necessary in a timely manner. In addition, banks have sometimes been unable or unwilling to satisfy their obligations under existing credit arrangements. Access to capital markets has recently been unavailable to most companies such as ours and there can be no assurance as to when the capital markets will recover. Equity financing, when and if available, could be dilutive to holders of our common stock, and debt financings would likely involve covenants that restrict our business operations. If we cannot raise funds on acceptable terms, if and when needed, we may not be able to develop or enhance our products, take advantage of future opportunities, grow our business or respond to competitive pressures or

unanticipated requirements, any of which could adversely affect our business, operating results and financial condition.

***The technology labor market is very competitive, and our business will suffer if we are unable to hire and retain key personnel.***

Our future success depends in part on the continued service of our key executive officers, as well as our research, engineering, sales, manufacturing and administrative personnel, most of whom are not subject to employment or non-competition agreements. In addition, competition for qualified personnel in the technology industry is intense, and we operate in geographic locations in which labor markets are particularly competitive. Our business is particularly dependent on expertise which only a very limited number of engineers possess. The loss of any of our key employees and officers, including our Chief Executive Officer, Chief Operating Officer or any of our Senior Vice Presidents, or the failure to attract and retain new qualified employees, would adversely affect our business, operating results and financial condition.

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***Fluctuations in currency exchange rates may adversely affect our financial condition and results of operations.***

Our international sales are denominated primarily, though not entirely, in U.S. dollars. Many of the costs and expenses associated with our Chinese subsidiaries are paid in Chinese Renminbi, and we expect our exposure to Chinese Renminbi to increase as we ramp up production in those facilities. In addition, purchases of some of our components are denominated in Japanese Yen. Changes in exchange rates among other currencies in which our revenue or costs are denominated and the U.S. dollar may affect our revenue, cost of sales and operating margins. While fluctuations in the value of our revenue, cost of sales and operating margins as measured in U.S. dollars have not materially affected our results of operations historically, we do not currently hedge our exchange exposure, and exchange rate fluctuations could have an adverse effect on our financial condition and results of operations in the future.

***If environmental contamination were to occur in one of our manufacturing facilities, we could be subject to substantial liabilities.***

We use substances regulated under various foreign, domestic, federal, state and local environmental laws in our manufacturing facilities. Our failure or inability to comply with existing or future environmental laws could result in significant remediation liabilities, the imposition of fines or the suspension or termination of the production of our products. In addition, we may not be aware of all environmental laws or regulations that could subject us to liability.

***If our facilities were to experience catastrophic loss due to natural disasters, our operations would be seriously harmed.***

Our facilities could be subject to a catastrophic loss caused by natural disasters, including fires and earthquakes. We have facilities in areas with above average seismic activity, such as our manufacturing facility in South San Francisco, California and our new manufacturing and headquarters facilities in Hayward, California. If any of our facilities were to experience a catastrophic loss, it could disrupt our operations, delay production and shipments, reduce revenue and result in large expenses to repair or replace the facility. In addition, we have in the past experienced, and may in the future experience, extended power outages at our facilities. We do not carry insurance policies that cover potential losses caused by earthquakes or other natural disasters or power loss.

***The market for our stock is subject to significant fluctuation.***

The size of our public market capitalization is relatively small, and the volume of our shares that are traded is low. The market price of our common stock could be subject to significant fluctuations. Among the factors that could affect our stock price are:

- quarterly variations in our operating results;
- our ability to successfully introduce new products and manage new product transitions;
- changes in revenue or earnings estimates or publication of research reports by analysts;
- speculation in the press or investment community;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- announcements relating to any of our key customers, significant suppliers or the semiconductor manufacturing and capital equipment industry generally;
- general market conditions;

the effects of war and terrorist attacks; and

domestic and international economic factors unrelated to our performance.

The stock markets in general, and the markets for technology stocks in particular, have experienced extreme volatility that has often been unrelated to the operating performance of particular companies. These broad market fluctuations may adversely affect the trading price of our common stock.

***We must maintain effective controls, and our auditors will report on them.***

The Sarbanes-Oxley Act of 2002 requires, among other things, that we maintain effective disclosure controls and procedures and internal control over financial reporting. In order to maintain and improve the effectiveness of our disclosure controls and procedures and internal control over financial reporting, significant resources and management oversight will be required. As a result, our management s attention might be diverted from other business concerns, which could have a material adverse effect on our business, financial condition and operating results. Any failure by us to maintain adequate controls or to adequately implement new controls could harm our operating results or cause us to fail to meet our reporting obligations. Inferior internal controls could also cause investors to lose confidence in our reported financial information, which could adversely affect the trading price of our common stock. In addition, we might need to hire additional accounting and financial staff with appropriate public company experience and technical accounting knowledge, and we might not be able to do so in a timely fashion.

**ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds**

None.

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**ITEM 3. Defaults Upon Senior Securities**

None.

**ITEM 4. Submission of Matters to a Vote of Security Holders**

We held our Annual Meeting of Stockholders on June 18, 2009. At the meeting, our stockholders voted on the following two proposals and cast their votes as follows to approve such proposals:

Proposal 1: The stockholders elected each of the following persons as a director to hold office until our 2009 Annual Meeting of Stockholders or until such director s earlier retirement, resignation or removal:

| Director s Name | Votes For | Votes Withheld |
|---|---|---|
| Susan H. Billat | 16,732,432 | 398,352 |
| John Chenault | 16,943,938 | 186,846 |
| Kevin C. Eichler | 16,622,782 | 508,002 |
| Clarence L. Granger | 16,758,478 | 372,306 |
| David T. ibnAle | 16,254,056 | 876,728 |
| Leonid Mezhvinsky | 16,803,675 | 327,109 |

Proposal 2: Stockholders ratified the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending January 2, 2009 with 17,090,259 affirmative votes, 25,183 negative votes and 15,342 votes abstaining.

**ITEM 5. Other Information**

None.

**ITEM 6. Exhibits**

(a) Exhibits

The following exhibits are filed with this current Report on Form 10-Q for the quarter ended July 3, 2009:

| Exhibit Number | Description |
|---|---|
| 10.1 | Separation and Release Agreement between the Company and Jack Sexton, dated April 29, 2009. |
| 31.1 | Certification of Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

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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.

**ULTRA CLEAN HOLDINGS, INC.**
(Registrant)

| | | |
|---|---|---|
| Date: August 27, 2009 | By: | /s/ Clarence L. Granger |
| | Name: | Clarence L. Granger |
| | Title: | Chairman and Chief Executive Officer<br>(Principal Executive Officer) |
| Date: August 27, 2009 | By: | /s/ Kevin C. Eichler |
| | Name: | Kevin C. Eichler |
| | Title: | Chief Financial Officer |

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**Exhibit Index**

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