ULTRA CLEAN HOLDINGS INC
Form 10-Q
August 09, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended July 2, 2010

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 **(State or other jurisdiction of** **incorporation or organization)**	**61-1430858** **(I.R.S. Employer** **Identification No.)**
26462 Corporate Avenue, Hayward, California **(Address of principal executive offices)**	**94545** **(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	x
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

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

Number of shares outstanding of the issuer s common stock as of July 30, 2010: 21,965,685

ULTRA CLEAN HOLDINGS, INC.

TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ULTRA CLEAN HOLDINGS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited; in thousands, except share amounts)

	July 2, 2010	January 1, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 23,101	$ 26,697
Accounts receivable, net of allowance of $125 and $529, respectively	45,691	34,787
Inventory	55,058	46,976
Prepaid expenses and other	2,800	6,005
Total current assets	126,650	114,465
Equipment and leasehold improvements, net	8,361	7,450
Purchased intangibles, net	8,987	8,987
Other non-current assets	386	408
Total assets	$ 144,384	$ 131,310
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Bank borrowings	$ 1,957	$ 2,008
Accounts payable	43,323	46,098
Accrued compensation and related benefits	4,320	2,378
Deferred rent, current portion	793	740
Other current liabilities	1,016	1,830
Total current liabilities	51,409	53,054
Long-term debt	16,149	13,092
Deferred rent and other liabilities	3,623	3,985
Total liabilities	71,181	70,131
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; 21,752,184 and 21,484,178 shares issued and outstanding, in 2010 and 2009, respectively	99,083	96,563
Common shares held in treasury, at cost, 601,944 shares in 2010 and 2009	(3,337)	(3,337)
Accumulated deficit	(22,543)	(32,047)
Total stockholders equity	73,203	61,179

Total liabilities and stockholders equity	$ 144,384	$ 131,310

(See accompanying notes to condensed consolidated financial statements)

3

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited; in thousands, except per share data)

	Three months ended		Six months ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Sales	$ 105,878	$ 23,252	$ 204,345	$ 45,652
Cost of goods sold	91,083	24,106	177,174	49,376
Gross profit (loss)	14,795	(854)	27,171	(3,724)
Operating expenses:				
Research and development	1,390	748	2,447	1,664
Sales and marketing	1,895	1,165	3,528	2,195
General and administrative	4,941	3,517	10,004	8,859
Total operating expenses	8,226	5,430	15,979	12,718
Income (loss) from operations	6,569	(6,284)	11,192	(16,442)
Interest and other income (expense), net	(145)	(228)	(300)	(423)
Income (loss) before provision for income taxes	6,424	(6,512)	10,892	(16,865)
Income tax provision	770	7,551	1,388	4,238
Net income (loss)	$ 5,654	$ (14,063)	$ 9,504	$ (21,103)
Net income (loss) per share:				
Basic	$ 0.26	$ (0.66)	$ 0.44	$ (0.99)
Diluted	$ 0.25	$ (0.66)	$ 0.41	$ (0.99)
Shares used in computing net income (loss) per share				
Basic	21,670	21,379	21,589	21,341
Diluted	23,016	21,379	22,905	21,341

(See accompanying notes to condensed consolidated financial statements)

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited; in thousands)

	Six months ended	
	July 2, 2010	**July 3, 2009**
Cash flows from operating activities:		
Net income (loss)	$ 9,504	$ (21,103)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,114	1,309
Deferred income tax		7,363
Excess tax benefit from stock-based compensation	(426)	
Stock-based compensation	1,577	1,564
Changes in assets and liabilities:		
Accounts receivable	(10,904)	3,464
Inventory	(8,082)	7,792
Prepaid expenses and other	3,205	3,761
Other non-current assets	22	(240)
Accounts payable	(2,822)	(97)
Accrued compensation and related benefits	1,942	(1,036)
Other liabilities	(694)	315
Net cash provided by (used in) operating activities	(5,564)	3,092
Cash flows from investing activities:		
Purchases of equipment and leasehold improvements	(2,024)	(153)
Proceeds from sale of equipment	46	
Net cash used in investing activities	(1,978)	(153)
Cash flows from financing activities:		
Principal payments on capital lease obligations	(3)	(10)
Proceeds from bank borrowings	4,000	5,500
Principal payments on short-term debt	(995)	(4,726)
Principal payments on long-term debt		(3,168)
Excess tax benefit from stock-based compensation	426	
Proceeds from issuance of common stock	518	46
Net cash provided by (used in) financing activities	3,946	(2,359)
Net increase (decrease) in cash	(3,596)	580
Cash and cash equivalents at beginning of period	26,697	29,620
Cash and cash equivalents at end of period	$ 23,101	$ 30,200
Supplemental items:		
Cash activities during the period for:		
Income taxes paid	$ 1,798	$
Income taxes refunded	$ 5,005	$ 6,600

Interest paid	$	412	$	209
Non-cash investing activities:				
Fixed asset purchases included in accounts payable	$	47	$	14

(See accompanying notes to condensed consolidated financial statements)

5

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Organization, Basis of Presentation and Significant Accounting Policies

Organization Ultra Clean Holdings, Inc. (the Company) is a developer and supplier of critical delivery subsystems, primarily for the semiconductor capital equipment industry, producing primarily gas delivery systems, chemical mechanical planarization (CMP) subsystems, chemical delivery modules, frame and top plate assemblies and process modules. The Company also leverages the specialized skill sets required to support semiconductor capital equipment to serve the technologically similar markets in the flat panel, solar and medical device industries. The Company s products improve efficiency and reduce the costs of its customers design and manufacturing processes. The Company s customers are primarily original equipment manufacturers (OEMs) of semiconductor capital equipment.

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 1, 2010 balance sheet data was 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 1, 2010, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 30, 2010. The Company s results of operations for the three and six months ended July 2, 2010, are not necessarily indicative of the results to be expected for any future periods.

Use of Accounting Estimates The presentation of financial statements in conformity with generally accepted accounting principles in the United States of America 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.

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The Company had significant sales to four customers: Applied Materials, Inc., Intuitive Surgical, Inc., Lam Research Corporation and Novellus Systems, Inc., two of which accounted for 10% or more of sales for the six months ended July 2, 2010. Sales to each of these customers as a percentage of total sales were as follows:

	Six months ended	
	July 2, 2010	July 3, 2009
Customer A	37.0%	36.8%
Customer B	27.0%	12.4%
Customer C	8.4%	22.5%
Customer D	9.2%	4.2%
Total	81.6%	75.9%

These four significant customers represented a combined total of 75.8% of accounts receivable at July 2, 2010. Two customer s accounts receivable balances were individually greater than 10% of accounts receivable and, in aggregate, represent 65.7% of accounts receivable.

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 The Company utilizes the asset and liability method of accounting for income taxes, under which deferred taxes are determined based on the temporary differences between the financial statement and tax basis of assets and liabilities using tax rates expected to be in effect during the years in which the basis differences reverse. A valuation allowance is recorded when it is more likely than not that some of the deferred tax assets will not be realized. As of July 2, 2010, the Company has a deferred tax valuation allowance totaling $7.9 million.

Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within the condensed consolidated statements of operations as income tax expense. During the second quarter of 2010, the Company received confirmation from tax authorities that certain tax audits were complete and closed and, consequently, the Company reduced its liability provision for accounting for uncertain tax positions.

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.

The Company has ongoing audits by various state and foreign taxing jurisdictions. Management believes that it has adequately provided for any adjustments that may result from these examinations, however, the outcome of tax audits cannot be predicted with certainty.

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 2, 2010	July 3, 2009
Beginning balance	$ 112	$ 164
Additions (reductions) related to sales	207	(14)
Warranty claims	(152)	(68)
Ending balance	$ 167	$ 82

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 its 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 generally 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 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).

Segments The Financial Accounting Standards Board s (FASB) guidance regarding disclosure about segments in an enterprise and related information 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.

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.

On June 10, 2010, the stockholders of the Company approved amendments to the Company s 2003 Amended and Restated Stock Incentive Plan, which included: an increase in share authorization by 1,500,000 common shares; the elimination of the Company s ability to increase further the number of shares under the plan without stockholder approval; and makes certain other changes to the 2003 Amended and Restated Stock Incentive Plan, all of which are more fully described in the Company s definitive proxy statement filed on April 23, 2010 .

Stock-Based Compensation Expense

The Company applies the fair value recognition provisions based on the FASB s guidance regarding *stock-based compensation*. The exercise price of each stock option equals the market price of the Company s stock on the date of grant. 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.

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

	Three months ended		Six months ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Dividend yield	0.0%	0.0%	0.0%	0.0%
Expected volatility	75.0%	70.0%	75.0%	50.8%
Risk-free interest rate	2.3%	2.3%	2.3%	2.1%
Forfeiture rate	12.0%	14.0%	12.0%	15.0%
Expected life (in years)	5.5	5.6	5.5	5.0

Stock Options

The following table summarizes information with respect to options outstanding at July 2, 2010:

	Number of Shares
Options outstanding at January 1, 2010	2,896,181
Granted	3,500
Exercised	(188,959)
Canceled	(135,277)
Options outstanding at July 2, 2010	2,575,445

The weighted-average exercise price, aggregate intrinsic value and weighted average remaining contractual life of outstanding options as of July 2, 2010 are $5.32 per share, $9.87 million and 6.6 years, respectively. As of July 2, 2010, 1,722,923 options with a weighted-average exercise price of $6.53 per share, aggregate intrinsic value of $4.8 million and a weighted average remaining contractual life of 5.6 years were exercisable. The total unamortized expense of the Company s unvested options, net of forfeitures, as of July 2, 2010, is $1.1 million of which substantially all is expected to be recognized over an estimated period of three years. The weighted average estimated fair value of employee stock option grants for the three and six months ended July 2, 2010, and July 3, 2009, was zero and $4.27 and $0.63 and $0.51 per share, respectively. The Company issued no stock option grants in the three months ended July 2, 2010.

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

The Company grants Restricted Stock Units (RSU s) to employees and Restricted Stock Awards (RSA) to non-employee directors as part of the Company s long term equity compensation plan.

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. The Company granted 614,500 RSU s during the first quarter ended April 2, 2010, with a weighted average fair value of $8.87 per share and granted 12,500 RSU s during the second quarter ended July 2, 2010, with a weighted average fair value of $9.33 per share. No RSU s were granted during the first quarter ended April 3, 2009, and 23,833 RSU s were granted during the second quarter ended July 3, 2009 with a weighted average fair value of $1.77 per share. As of July 2, 2010, $4.1 million of stock-based compensation cost, net of forfeitures, related to RSU s remains to be amortized, of which substantially all is expected to be recognized over an estimated period of less than three years. As of July 2, 2010, a total of 913,641 RSU s and RSA s remain outstanding with an aggregate intrinsic value of $7.0 million and a weighted average remaining contractual term of 1.6 years.

During the current quarter, the Company issued 30,000 shares of restricted stock awards to its non-employee directors. For purposes of determining compensation expense related to these RSA s, the fair value is determined based on the closing market price of the Company s common stock on the date of award. The weighted average fair value of the shares was $7.58 per share and was determined using the Company s closing market price on the date of grant. These shares fully vest on the earlier of the day before the next annual shareholder s meeting or the one year anniversary of the date of grant. The total unamortized expense of the Company s unvested restricted stock awards as of July 2, 2010 was approximately $0.2 million.

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table summarizes the Company s restricted stock unit and restricted stock award activity for the six months ended July 2, 2010 (in thousands):

	Number of Shares
Unvested restricted stock units and restricted stock awards at January 1, 2010	359
Granted	657
Vested	(81)
Forfeited	(21)
Unvested restricted stock units and restricted stock awards at July 2, 2010	914

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 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Cost of sales	$ 219	$ 216	$ 414	$ 424
Research and development	108	11	101	
Sales and marketing	116	56	185	123
General and administrative	467	492	877	1,017
	910	775	1,577	1,564
Income tax benefit	(109)	(248)	(201)	(500)
Total stock-based compensation expense	$ 801	$ 527	$ 1,376	$ 1,064

Recently Issued Accounting Standards In January 2010, the FASB issued authoritative guidance for fair value measurements, which requires additional disclosures and clarifications to existing disclosures. This authoritative guidance requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and also to describe the reasons for these transfers. This authoritative guidance also requires enhanced disclosure of activity in Level 3 fair value measurements. The new disclosures and clarifications of existing disclosures for Level 1 and Level 2 fair value measurements becomes effective the first interim reporting period after December 15, 2009. The adoption of this guidance had no financial impact on the Company s condensed consolidated financial statements or related footnotes.

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

2. Balance Sheet Information (in thousands)

Inventory consisted of the following (in thousands):

	July 2, 2010	January 1, 2010
Raw materials	$ 44,246	$ 36,587
Work in process	13,741	14,071
Finished goods	2,619	1,154
	60,606	51,812
Reserve for obsolescence	(5,548)	(4,836)
Total	$ 55,058	$ 46,976

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

	July 2, 2010	January 1, 2010
Computer equipment and software	$ 6,251	$ 6,057
Furniture and fixtures	1,467	802
Machinery and equipment	6,313	5,465
Leasehold improvements	9,680	9,577
	23,711	21,901
Accumulated depreciation and amortization	(15,350)	(14,451)
Total	$ 8,361	$ 7,450

3. Borrowing Arrangements

In 2006, the Company entered into a borrowing arrangement (Loan Agreement) with a bank. 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).

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 Original Term Loan expired on June 29, 2009. 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 the Company s 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. In May 2010, the Company was not in compliance with one of its financial covenants, however, the Company received a permanent waiver for the May non-compliance from the bank. During the quarter ended April 2, 2010, the Company increased borrowings under its Revolving Line of Credit by $4.0 million. The outstanding balance of the Loan Agreement as of July 2, 2010, was approximately $17.1 million.

Interest rates on outstanding loans under the revolving credit facility and the term loan were 4.25% and 4.75% per annum, respectively, during the quarter and six months ended July 2, 2010.

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 $1.0million, respectively, as of July 2, 2010.

The combined balance outstanding on the Loan Agreement and equipment loan as of July 2, 2010 was $18.1 million.

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 the FASB s guidance regarding *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 six months ended July 2, 2010, the Company made payments of $124,000 and charged to expense $82,000 of remaining estimated future sublease income due to the anticipated continued vacancy of the facility through the lease termination date. The balance of the restructuring accrual as of July 2, 2010 is $85,000.

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 and related effective tax rate for the three and six month periods ended July 2, 2010, was $770,000 and 12.0% and $1,388,000 and 12.7%, respectively. The Company s income tax provision and related effective tax rate for the three and six month periods ended July 3, 2009, was $7,551,000 and 116% and $4,238,000 and 25.1%, respectively. The provision for the six months ended July 2, 2010, reflects, in part, a reversal of $882,000 of previously established tax liability related to the Company s uncertain tax positions. The provision for the six months ended July 3, 2009, reflects, in part, the establishment of a valuation allowance of $7.0 million.

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

	Six months ended	
	July 2, 2010	**July 3, 2009**
Balance as of the beginning of period	$ 920	$ 428
Increases related to prior year tax positions	1	
Decreases related to the finalization of tax audits	(882)	
Balance as of the end of period	$ 39	$ 428

Although we believe we have adequately reserved for our uncertain tax positions, no assurance can be given that the final tax outcome of these matters will not be different. We adjust these reserves in light of changing facts and circumstances, such as the closing of a tax audit or the refinement of an estimate. To the extent that the final tax outcome of these matters is different than the amounts recorded, such differences will impact the provision for income taxes in the period in which such determination is made. The provision for income taxes includes the impact of reserve provisions and changes to reserves that are considered appropriate, as well as the related net interest. We file income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. The Company s 2005 and 2006 state income tax returns are currently under examination by the California Franchise Tax Board (CFTB) and the Company s state income tax returns are open to audit under the statute of limitations for the fiscal years 2005 through 2009. The Company is also subject to examination in various other jurisdictions for various periods. During the second quarter of 2010, the IRS completed their audit of the Company s tax returns for the years 2006 through 2009. An assessment of approximately $110,000, excluding interest, was agreed to by the Company.

The determination of our tax provision is subject to judgments and estimates. The carrying value of our net deferred tax assets, which is made up primarily of tax deductions, assumes we will be able to generate sufficient future income to fully realize these deductions. In determining whether the realization of these deferred tax assets may be impaired, we make judgments with respect to whether we are likely to generate sufficient future taxable income to realize these assets. As of July 2, 2010, we have recorded a tax valuation allowance totaling $7.9 million.

The Company is currently experiencing a tax holiday related to its Singapore subsidiary that will expire for tax years beginning January 2015.

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.

Table of Contents

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Numerator:				
Net income (loss)	$ 5,654	$ (14,063)	$ 9,504	$ (21,103)
Denominator:				
Shares used in computation basic:				
Weighted average common shares outstanding	21,670	21,379	21,589	21,341
Weighted average common shares outstanding subject to repurchase	( )	( )	( )	( )
Shares used in computing basic net income (loss) per share	21,670	21,379	21,589	21,341
Shares used in computation diluted:				
Weighted average common shares outstanding	21,670	21,379	21,589	21,341
Dilutive effect of common shares outstanding subject to repurchase	215		205	
Dilutive effect of options outstanding	1,131		1,111	
Shares used in computing diluted Net income (loss) per share	23,016	21,379	22,905	21,341
Net income (loss) per share basic	$ 0.26	$ (0.66)	$ 0.44	$ (0.99)
Net income (loss) per share diluted	$ 0.25	$ (0.66)	$ 0.41	$ (0.99)

The Company had securities outstanding which could potentially dilute basic earnings per share in the future. Potentially dilutive securities include outstanding options, shares to be purchased under the employee stock purchase plan and unvested RSUs. The dilutive effect of potentially dilutive securities is reflected in diluted earnings per common share by application of the treasury stock method. However, the incremental shares from the assumed exercise of these securities are excluded in the computation of diluted net loss per share, as their effect would be anti-dilutive. Weighted average potential common shares of 1.7 million shares for each of the three and six month periods ended July 3, 2009, have been excluded from the computation of diluted net loss per share because their inclusion would be anti-dilutive.

7. Related Party Transactions

The Company leases a facility from an entity controlled by one of the Company s board members. The Company incurred rent expense resulting from the lease of this facility of $67,000 and $134,000 for the three and six months ended July 2, 2010 , respectively, and $67,000 and $134,000 for the three and six months ended July 3, 2009, 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 $142,000 and $230,000 for the three and six months ended July 2, 2010 and $51,000 and $105,000 for the three and six month periods ended July 3, 2009, respectively.

8. Commitments and Contingencies

The Company had commitments to purchase inventory totaling approximately $34.7 million at July 2, 2010.

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 has received incentives of approximately $1.2 million in rent abatements as of July 2, 2010. 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 two years. The Company s total future minimum lease payments over the term of the lease will be approximately $8.2 million.

ULTRA CLEAN HOLDINGS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

From time to time, the Company is 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.

9. Segment Information

The Company operates in one reportable segment and is engaged in the development, manufacture and supply of critical subsystems for the semiconductor capital equipment, flat panel, medical, energy and research industries. The nature of the Company s products and production processes as well as type of customers and distribution methods is consistent among all of the Company s products. The Company s foreign operations are conducted primarily through its wholly-owned subsidiary in China. The Company s principal markets include North America, Europe and Asia. Sales by geographic area represent sales to unaffiliated customers.

All information on sales by geographic area is based upon the location to which the products were shipped. The following table sets forth revenue by geographic area (in thousands):

	Three months ended		Six months ended	
	July 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
United States	$ 97,065	$ 22,888	$ 192,773	$ 45,450
Export sales to Europe and Asia	8,813	364	11,572	202
	$ 105,878	$ 23,252	$ 204,345	$ 45,652

At July 2, 2010 and July 3, 2009, approximately $2.6 million and $1.2 million, respectively, of the Company s long-lived assets were located in China and Singapore, and the remaining balances were located in the United States.

Table of Contents

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, primarily for the semiconductor capital equipment industry. We also leverage the specialized skill sets required to support semiconductor capital equipment to serve the technologically similar markets in the flat panel, medical, energy and research industries, collectively referred to as Other Addressed 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 Other Addressed Industries. Our revenue is derived primarily from the sale of gas delivery systems and other critical subsystems including chemical mechanical planarization (CMP) subsystems, chemical delivery modules, top-plate assemblies, frame assemblies, process modules and other high level assemblies.

As a group, our four largest customers accounted for approximately 82% of the Company s sales in the first half of 2010.

Financial Highlights

Our operating results for the three months ended July 2, 2010, compared to the same period in the prior year reflects an increase in demand of our products, primarily in the semiconductor capital equipment market. Sales for the three months ended July 2, 2010 were $105.9 million, an increase of $82.6 million, or 355.4%, from the comparable quarter of 2009. Gross profit (loss) in the second quarter of 2010 increased $15.6 million, to 14.8 million, or 14.0% of sales, from $(0.9) million, or (3.7)% of sales, in the second quarter of 2009. Total operating expenses in the second quarter of 2010 increased to $8.2 million, or 7.8% of sales, compared to $5.4 million, or 23.4% of sales, for the second quarter of 2009. We earned net income of $5.7 million for the second quarter in 2010 compared to a net loss during the second quarter of 2009 of $14.1 million as a result of a substantial increase in sales and gross profits.

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 2, 2010	July 3, 2009	July 2, 2010	July 3, 2009
Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	86.0%	103.7%	86.7%	108.2%
Gross profit (loss)	14.0%	(3.7)%	13.3%	(8.2)%
Operating expenses:				
Research and development	1.3%	3.2%	1.2%	3.6%
Sales and marketing	1.8%	5.0%	1.7%	4.8%
General and administrative	4.7%	15.1%	4.9%	19.4%
Total operating expenses	7.8%	23.4%	7.8%	27.9%
Income (loss) from operations	6.2%	(27.0)%	5.5%	(36.0)%

Interest and other income (expense), net	(0.1)%	(1.0)%	(0.1)%	(0.9)%
Income (loss) before provision for income taxes	6.1%	(28.0)%	5.3%	(36.9)%
Income tax provision	0.7%	32.5%	0.7%	9.2%
Net income (loss)	5.4%	(60.5)%	4.6%	(46.2)%

Sales

Sales in the second quarter of 2010 increased $82.6 million, or 355.4%, to $105.9 million from $23.3 million in the second quarter of 2009. Sales for the first six months of 2010 increased $158.7 million, or 347.6%, to $204.3 million from $45.6 million in the first six months of 2009. The increase in sales for the second quarter and first half of 2010 reflects a recovery of semiconductor equipment demand since the overall slowdown in the industry. Substantially all of the revenue increase is attributable to volume increases with existing customers. We expect sales to continue to rise in the third quarter of 2010.

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 2, 2010, increased $15.7 million to $14.8 million, or 14.0% of sales, from $(0.9) million, or (3.7)% of sales, for the same period in 2009. Gross profit (loss) for the six months ended July 2, 2010, increased $30.9 million to $27.2 million, or 13.3% of sales, from $(3.7) million, or (8.2)% of sales, for the same period in 2009. Our gross margin for the three and six months ended July 2, 2010 increased from the comparable periods in 2009 due primarily to increased unit volume manufactured due to increased sales during the first half of fiscal 2010 and greater factory utilization. Our gross margin for the three and six months ended July 3, 2009 reflected low unit volume manufactured due to decreased sales during the first half of fiscal 2009, lower factory utilization and employee severance charges resulting from a series of reductions in force.

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 three months ended July 2, 2010, increased $0.6 million, or 85.8%, to $1.4 million, or 1.3% of sales, compared to $0.7 million, or 3.2% of sales in the same quarter in 2009. Research and development expense for the six months ended July 2, 2010, increased $0.8 million, or 47.1%, to $2.4 million, or 1.2% of sales, compared to $1.6 million, or 3.6% of sales in the comparable period in 2009. The decrease in percent of research and development expense for the quarter and first half of 2010 is due to an increase in sales during the first half of 2010 as compared to the quarter and first half of 2009. The increase in expense is primarily due to headcount increases 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, salaries paid to our engineers who work with the sales and service employees to help determine the components and configuration requirements for new products and other costs related to the sales of our products.

Sales and marketing expense for the three months ended July 2, 2010, increased $0.7 million to $1.9 million, or 1.8% of sales, compared to $1.2 million, or 5.0% of sales, in the comparable period of 2009. Sales and marketing expense for the six months ended July 2, 2010, increased $1.3 million to $3.5 million, or 1.7% of sales, compared to $2.2 million, or 4.8% of sales, in the comparable period of 2009. The decrease in percent of sales and marketing expense for the quarter and first half of 2010 is due to an increase in sales during the first half of 2010 as compared to the quarter and first half of 2009. The increase in dollars when comparing the quarter and first half of 2010 with the quarter and first half of 2009 is primarily due to increased commissions and payroll and related benefit costs due to an increase in headcount.

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 increased approximately $1.4 million, or 40.5% in the second quarter of 2010 to $4.9 million, or 4.7% of sales, compared with $3.5 million, or 15.1% of sales, in the comparable quarter of 2009. General and administrative expense increased approximately $1.1 million, or 12.8% in the first half of 2010 to $10.0 million, or 4.9% of sales, compared with $8.9 million, or 19.4% of sales, in the comparable period of 2009. The increase in dollars when comparing the quarter and first half 2010 with the quarter and first half 2009 is due to internal cost containment measures and reductions in fees for outside professional services offset by payroll and related benefit costs associated with an increase in headcount. The decrease in general and administrative expense as a percent of sales in the quarter and first half of 2010 compared to the quarter and first half of 2009 is due to increased sales.

Interest and Other Income (Expense), net

Interest and other income (expense), net for the second quarter of 2010 was $(0.1) million compared to $(0.2) million in the second quarter of 2009. Interest and other income (expense), net for the first half of 2010 was $(0.3) million compared to $(0.4) million in the first half of 2009. The Company experienced an increase in net interest expense for the three months ended July 2, 2010, attributable to an increase in the revolving line of credit slightly offset by reductions in interest on equipment loans. The second quarter of 2010 also includes a $46,000 gain on sale of assets.

Income Tax Provision

Our effective tax rate for the six months ended July 2, 2010 and July 3, 2009, was 12.7% and 25.1%, respectively. The change in respective rates reflects, primarily, the establishment of a valuation allowance in 2009 and, the remainder, a change in the geographic mix of worldwide earnings and financial results for first half of 2010 compared to the comparable period in 2009. In addition, the provision for the three and six months ended July 2 , 2010, reflects the reversal of $882,000 of previously established tax liability related to the Company s uncertain tax positions.

The Company s ability to realize deferred tax assets depends on its ability to generate sufficient taxable income of the same character within the carryback or carryforward periods. In assessing future GAAP taxable income, the Company has considered all sources of taxable income available to realize its deferred tax asset, 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. If changes occur in the assumptions underlying the Company s tax planning strategies or in the scheduling of the reversal of the Company s deferred tax liabilities, the valuation allowance may need to be adjusted in the future.

Table of Contents

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 2, 2010, we had cash and cash equivalents of $23.1 million compared to $26.7 million as of January 1, 2010.

For the six months ended July 2, 2010 we used cash from operating activities of $5.6 million compared to $3.1 million of cash generated by operating activities for the comparable period in the prior year. Operating cash flows for the first half of 2010 were favorably impacted by net non-cash activity of $2.7 million, including depreciation and amortization of $1.1 million and stock-based compensation of $1.6 million, and an increase in accrued compensation and related benefits of $1.9 million. Cash from operating activities was unfavorably impacted by increases in accounts receivable and inventory of $10.9 million and $8.1 million, respectively, and a decrease in accounts payable of $2.8 million, partially offset by a decrease in prepaid expenses and other of $3.2 million.

Our cash flows from operations in any given period are largely driven by the timing of sales, the collection of accounts receivable and the payments of accounts payable.

Cash flows used in investing activities increased $1.8 million when comparing the first half of 2010 to the comparable period in 2009 due primarily to increases in capital spending.

Net cash provided by financing activities for the first half of 2010 was $3.9 million compared to cash used of $2.4 million in the comparable period of the prior year. Our cash provided by financing activities in the first half of 2010 was primarily due to increased borrowings under the Company s revolving line of credit by $4.0 million, proceeds from option exercises and the employee stock purchase plan of $0.5 million and excess tax benefit from stock-based compensation of $0.4 million, offset by payments on short-term debt and capital lease obligations of $1.0 million.

We anticipate that our existing cash balances and operating cash flow, together with available borrowings under our credit facility, 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 2, 2010. Of the $14.1 million in operating leases, $85,000 is included in other accrued liabilities as of July 2, 2010.

	2010	2011	2012	2013	2014	Thereafter	Total
Capital lease	$ 5	$ 10	$ 10	$ 10	$ 7	$	$ 42
Operating lease (1)	2,028	3,452	3,048	2,779	2,349	467	14,123
Borrowing arrangements	1,014	1,443	15,649				18,106
Total	$ 3,047	$ 4,905	$ 18,707	$ 2,789	$ 2,356	$ 467	$ 32,271

(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; (c) the leases for manufacturing facilities in South San Francisco that expire in 2011 thru 2013; (d) the leases for manufacturing facilities in Austin, Texas that expire in 2013 and 2014; (e) and leases for manufacturing facilities in Asia that expire in 2011 thru 2014. We have options to renew certain of the leases in South San Francisco, which we expect to

exercise.

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 2009 Annual Report on Form 10-K as filed with the SEC on March 30, 2010. No material changes to our significant accounting policies and critical estimates have occurred subsequent to January 1, 2010.

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.

Recently, Chinese authorities have relaxed controls of its currency, the renminbi , and allowed the currency to strengthen against other world currencies. The Company continues to monitor any potential impact of the renminbi currency revaluation on its operations in China as well as globally.

Interest Rates

Our interest rate risk relates primarily to our third party debt which totals $18.1 million as of July 2, 2010, 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 $45,000 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 $45,000 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 upon our evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective for the quarter ended July 2, 2010.

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. Under the supervision and with the participation of our management, including our CEO and CFO, we conducted an assessment of the effectiveness of our internal control over financial reporting as of July 2, 2010. Based on our evaluation under the framework in *Internal Control Integrated Framework*, management has concluded that our internal control over financial reporting was effective for the quarter ended July 2, 2010.

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.

Table of Contents

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 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. 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.

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 in the semiconductor capital equipment, flat panel, medical, energy and research industries, 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 increased 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 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. As a group, four customers accounted for 82% of the Company s sales in the first half of 2010. Also, as a group, three customers accounted for 79% and 81% of the Company s sales for fiscal years 2009 and 2008, respectively. 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 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.

We are exposed to risks associated with the global economy.

Our sales were $204.3 million for the first half of 2010 compared to $45.7 million for the first half of 2009. We earned a net profit $9.5 million in the first half of 2010 compared to a net loss of $(21.1) million for the comparable period in the previous year. While it appears that the economy has entered a period of recovery, we may experience future economic slowdowns and fluctuations in customer orders. Also, as a result of the global economy, certain of our suppliers have been or 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.

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 have made capital expenditures of $2.0 million during the twelve months ended July 2, 2010, related to the development of our manufacturing facilities in China and Singapore. 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. 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.

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 Asia, which exposes us to risks associated with operating in a foreign country.

We intend to expand, as markets will allow, our operations in Asia, which includes China and Singapore. Our total assets in Asia at July 2, 2010, were approximately $40.5 million.

We are exposed to political, economic, legal and other risks associated with operating in Asia, 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 Asia 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 Asia 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.

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 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.

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.

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 the markets we serve requires us 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.

24

Table of Contents

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 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.

Table of Contents

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 2010, our long-term debt was $16.1 million and our short-term debt was $2.0 million, for an aggregate total of $18.1 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;
- 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. In May 2010, the Company was not in compliance with one of its financial covenants, however, the Company received a permanent waiver for the May non-compliance from the bank. 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.

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.

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 and Singapore subsidiary are paid in Chinese Renminbi and Singapore dollars, respectively, and we expect our exposure to Chinese Renminbi and Singapore dollars to increase as we ramp up production in those facilities. In addition, purchases of some of our components are denominated in Japanese Yen and Euro. 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.

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.

Table of Contents

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.

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 are 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.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. (Removed and Reserved)

None.

ITEM 5. Other Information

None.

Table of Contents

ITEM 6. Exhibits

(a) Exhibits

The following exhibits are filed with this current Report on Form 10-Q for the quarter ended July 2, 2010:

Exhibit Number	Description
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.

29

Table of Contents

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 9, 2010

By:	/s/ CLARENCE L. GRANGER
Name:	**Clarence L. Granger**
Title:	**Chairman and Chief Executive Officer (Principal Executive Officer)**

Date: August 9, 2010

By:	/s/ KEVIN C. EICHLER
Name:	**Kevin C. Eichler**
Title:	**Chief Financial Officer**

Exhibit Index

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