ULTRA CLEAN HOLDINGS INC
Form 10-Q
August 06, 2008

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q

(Mark One)

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

For the quarterly period ended June 27, 2008

or

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

For the transition period from to

Commission file number 000-50646

Ultra Clean Holdings, Inc.

(Exact name of registrant as specified in its charter)

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

(650) 323-4100

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 þ No o

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

Large accelerated filer	Accelerated filer	Non-accelerated filer	Smaller reporting company
o	þ	o	o

(Do not check if a 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 o No þ

Number of shares outstanding of the issuer s common stock as of July 31, 2008: 21,748,167.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

ULTRA CLEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share amounts)

	June 27, 2008 (Unaudited)	December 28, 2007
ASSETS		
Current assets:		
Cash and cash equivalents	$ 32,571	$ 33,447
Accounts receivable, net of allowance of $440 and $352, respectively	26,638	34,845
Inventory, net	43,634	49,342
Deferred income taxes	3,955	3,597
Prepaid expenses and other	4,839	4,110
Total current assets	111,637	125,341
Equipment and leasehold improvements, net	20,479	14,095
Other long-term assets:		
Goodwill, net	34,196	34,196
Purchased intangibles, net	20,087	20,762
Other non-current assets	548	633
Total assets	$ 186,947	$ 195,027
LIABILITIES & STOCKHOLDERS EQUITY		
Current liabilities:		
Bank borrowings	$ 3,400	$ 3,575
Accounts payable	22,559	36,817
Accrued compensation and related benefits	2,359	3,006
Other current liabilities	1,230	1,445
Total current liabilities	29,548	44,843
Long-term debt	17,136	18,636
Deferred and other tax liabilities	853	1,031
Deferred rent and other liabilities	5,319	1,029
Total liabilities	52,856	65,539
Commitments and contingencies (See note 9)		
Stockholders equity:		
Preferred stock $0.001 par value, 10,000,000 authorized; none outstanding		
Common stock $0.001 par value, 90,000,000 authorized; 21,705,109 and 21,562,836 shares issued and outstanding, in 2008 and 2007, respectively	91,968	89,092
Retained earnings	42,123	40,396

Total stockholders equity	134,091	129,488
Total liabilities and stockholders equity	$ 186,947	$ 195,027

(See accompanying notes to condensed consolidated financial statements.)

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ULTRA CLEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; in thousands, except per share data)

	Three months ended		Six months ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Sales	$ 67,364	$ 104,722	$ 159,721	$ 215,514
Cost of goods sold	59,842	88,906	140,139	182,941
Gross profit	7,522	15,816	19,582	32,573
Operating expenses:				
Research and development	606	785	1,391	1,627
Sales and marketing	1,327	1,336	2,960	2,759
General and administrative	6,252	6,182	12,882	12,779
Total operating expenses	8,185	8,303	17,233	17,165
Income (loss) from operations	(663)	7,513	2,349	15,408
Interest and other income (expense), net	246	(459)	590	(990)
Income (loss) before provision for income taxes	(909)	7,054	1,759	14,418
Income tax provision (benefit)	(747)	1,958	32	4,137
Net income (loss)	$ (162)	$ 5,096	$ 1,727	$ 10,281
Net income (loss) per share:				
Basic	$ (0.01)	$ 0.24	$ 0.08	$ 0.49
Diluted	$ (0.01)	$ 0.23	$ 0.08	$ 0.47
Shares used in computing net income (loss) per share				
Basic	21,643	21,236	21,604	21,188
Diluted	21,643	22,045	22,126	22,012

(See accompanying notes to condensed consolidated financial statements)

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ULTRA CLEAN HOLDINGS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited; in thousands)

	Six months ended	
	June 27, 2008	June 29, 2007
Cash flows from operating activities:		
Net income	$ 1,727	$ 10,281
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation and amortization	2,400	2,138
Deferred income tax	(536)	(686)
Excess tax benefit from stock-based compensation	(237)	(692)
Stock-based compensation	1,921	1,482
Changes in assets and liabilities:		
Accounts receivable, net of allowance	8,207	(5,301)
Inventory, net	5,708	(952)
Prepaid expenses and other	(684)	383
Other non-current assets	85	(12)
Accounts payable	(14,290)	(4,604)
Accrued compensation and related benefits	(647)	(406)
Income taxes payable	(45)	(2,446)
Other liabilities	4,323	1,857
Net cash provided by operating activities	7,932	1,042
Cash flows from investing activities:		
Purchases of equipment and leasehold improvements	(8,078)	(3,094)
Net cash used in acquisition		(46)
Net cash used in investing activities	(8,078)	(3,140)
Cash flows from financing activities:		
Principal payments on capital lease obligations	(10)	(31)
Principal payments on long-term debt	(1,675)	(2,693)
Excess tax benefit from stock-based compensation	238	692
Proceeds from issuance of common stock	717	751
Net cash used in financing activities	(730)	(1,281)
Net decrease in cash	(876)	(3,379)
Cash and cash equivalents at beginning of period	33,447	23,321
Cash and cash equivalents at end of period	$ 32,571	$ 19,942

Supplemental items:

Income taxes paid	$ 793	$ 6,570
Interest paid	$ 583	$ 1,220

(See accompanying notes to condensed consolidated financial statements)

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ULTRA CLEAN HOLDINGS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Organization, Basis of Presentation and Significant Accounting Policies

Organization - Ultra Clean Holdings, Inc. (the Company) is a developer and supplier of critical subsystems, primarily for the semiconductor capital equipment (SCE) industry. The Company also leverages the specialized skill sets required to support SCE to serve the technologically similar markets in the flat panel, solar and medical device industries. The Company s revenue is derived from the sale of gas delivery systems and other critical subsystems including chemical mechanical planarization (CMP) subsystems, chemical delivery modules, frame and top plate assemblies and process modules and other high level assemblies. 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 December 28, 2007 balance sheet data were derived from audited financial statements as of that date. All significant intercompany transactions and balances have been eliminated from the information provided.

The unaudited condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements for the fiscal year ended December 28, 2007, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 12, 2008. The Company s results of operations for the three months ended June 27, 2008 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.

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 to semiconductor capital equipment manufacturers in the United States. The Company performs credit evaluations of its customers financial condition and generally requires no collateral.

The Company had significant sales to three customers, each accounting for 10% as of June 27, 2008 or more of our total sales for the quarter: Applied Materials, Inc., Lam Research Corporation and Intuitive Surgical, Inc. As a group these three customers accounted for 80% of the Company s sales for the quarter ended June 27, 2008. For the six months ended June 27, 2008, two customers each accounted for 10% or more of our total sales: Applied Materials, Inc. and Lam Research Corporation. As a group these two customers accounted for 71% of the Company s sales for the six months ended June 27, 2008. For the three and six months ended June 29, 2007, three customers each accounted for 10% or more of our total sales: Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc. As a group these three customers accounted for 83% of the Company s sales for the three and six months ended June 29, 2007.

The Company had two customers whose accounts receivable balances were each greater than 10% as of June 27, 2008. In aggregate these two customers represented approximately 60.3% of our trade accounts receivable as of June 27, 2008.

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

Income Taxes Income taxes were reported under Statement of Financial Accounting Standards No. 109, *Accounting for Income Taxes* , (SFAS 109) and, accordingly, deferred taxes are recognized using the asset and liability method, whereby deferred tax assets and liabilities are recognized for the future tax consequence attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax base, and operating loss and tax credit carry-forwards. Valuation allowances are provided if it is more likely than not that some or all of the deferred tax assets will not be recognized. For the six month periods presented, the Company has neither a net loss or tax credit carry-forwards and no valuation allowance was deemed necessary.

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	
	June 27, 2008	**June 29, 2007**
Beginning balance	$ 220	$ 344
Additions related to sales	79	52
Warranty claims	(110)	(167)
Ending balance	$ 189	$ 229

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Revenue Recognition Revenue from the sale of products 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 does not require collateral from customers.

Stock-Based Compensation The Company maintains a stock-based compensation plan which allows 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 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	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Cost of sales	$ 249	$ 211	$ 503	$ 407
Research and development		69	62	93
Sales and marketing	91	19	127	56
General and administrative	480	476	1,231	828
	820	775	1,923	1,384
Income tax benefit	(673)	(213)	(35)	(393)
Total stock-based compensation expense	$ 147	$ 562	$ 1,888	$ 991

Stock Options

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

	Three months ended		Six months ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Dividend yield		0.0%	0.0%	0.0%
Expected volatility		50.0%	50.0%	50.0%
Risk-free interest rate		4.7%	2.8%	4.7%
Forfeiture rate		11.0%	7.0%	11.0%
Expected life (in years)		5.0	5.0	5.0

The Company did not grant stock options during the second quarter of 2008. The weighted average estimated fair value of employee stock option grants for the six months ended June 27, 2008 was $4.71. The computation of the expected volatility assumption used in the Black-Scholes calculations for new grants is based on a combination of the Company s historical volatility and the volatility of similar companies in our industry. The risk-free interest rate

assumption is based upon observed interest rates appropriate for the term of the Company s employee stock options. The Company does not currently pay dividends and has no plans to do so in the future. The forfeiture rate is based on the Company s historical option forfeitures, as well as management s expectation of future forfeitures based on current market conditions. When establishing the expected life assumption, the Company reviews annual historical employee exercise behavior of option grants with similar vesting periods.

The following table summarizes information with respect to options outstanding at June 27, 2008:

	Number of Shares
Options outstanding at December 28, 2007	2,927,336
Granted	102,000
Exercised	(131,443)
Canceled	(409,444)
Options outstanding at June 27, 2008	2,488,449

The total unamortized expense of the Company s unvested options as of June 27, 2008, is $5.2 million.

Employee Stock Purchase Plan

The Company also maintains an employee stock purchase plan (ESPP) that provides for the issuance of shares to all eligible

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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. During the six months ended June 27, 2008 and June 29, 2007, 11,449 and 8,203 shares, respectively, were issued under the Company s ESPP.

Restricted Stock Units and Restricted Stock Awards

During the first quarter of fiscal 2008, the Company began granting Restricted Stock Units (RSU s) to employees as part of the Company s long term equity compensation plan. These RSU s are granted to employees with a per share or unit purchase price of zero dollars and either have time based or performance based vesting. RSU s typically vest over three years, subject to the employee s continued service with the Company. Certain of these RSU s vest only if specific performance goals set by the Compensation Committee are achieved. 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 and, for performance shares, expense recognition begins once management determines it is probable that the performance goals will be achieved. If the performance goals are achieved, the grant vests over a specified service period. If such goals are not achieved, no compensation cost is recognized and any previously recognized compensation expense is reversed. The expected cost of the grant is reflected over the service period, and is reduced for estimated forfeitures. During the three and six month periods ended June 27, 2008, the Company approved and granted 8,000 and 380,600 RSU s, respectively, to employees with a weighted average fair value of $9.91 and $9.86, respectively. As of June 27, 2008, $2.3 million of unrecognized stock-based compensation cost related to RSU s remains to be amortized and is expected to be recognized over an estimated period of three years.

On May 31, 2008, the Company issued 37,500 shares of restricted stock awards to its outside directors. The fair value of the shares was determined using the Company s closing market price on the date of grant. These shares fully vest on the one year anniversary from the date of grant. The total unamortized expense of the Company s unvested restricted stock awards as of June 27, 2008, is $0.4 million.

The following table summarizes the Company s restricted stock unit and restricted stock award activity for the six months ended June 27, 2008 (in thousands):

	Number of Shares
Unvested restricted stock units and restricted stock awards at December 28, 2007	41
Granted	418
Vested	(41)
Canceled	(24)
Unvested restricted stock units and restricted stock awards at June 27, 2008	394

Recently Issued Accounting Standards In December 2007, the FASB issued SFAS No. 141 (revised), Business Combinations (SFAS 141(R)). The standard changes the accounting for business combinations, including the measurement of acquirer shares issued in consideration for a business combination, the recognition of contingent consideration, the accounting for preacquisition gain and loss contingencies, the recognition of capitalized in-process research and development, the accounting for acquisition-related restructuring cost accruals, the treatment of acquisition related transaction costs, and the recognition of changes in the acquirer s income tax valuation allowance. SFAS 141(R) will be effective for the Company in fiscal 2009, with early adoption prohibited. Ultra Clean is evaluating the potential impact of the implementation of SFAS 141(R) on its financial position and results of operations.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*. SFAS No. 159 allows entities the option to measure eligible financial instruments at fair value as of specified dates. Such election, which may be applied on an instrument by instrument basis, is typically irrevocable once elected. SFAS No. 159 is effective for the Company beginning December 29, 2007. The Company determined that this pronouncement will have no impact on its financial position, results of operation and cash flows.

In September 2006, the FASB issued SFAS No.157, *Fair Value Measurements* (SFAS 157), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements; rather, it applies under other accounting pronouncements that require or permit fair value measurements. The Company adopted SFAS No.157 as required on December 29, 2007 and has determined that the impact of SFAS 157 on its consolidated financial statements are not material.

2. Inventory, net (in thousands)

	June 27, 2008	December 28, 2007
Raw materials	$ 31,555	$ 35,625
Work in process	13,675	15,449
Finished goods	3,032	2,556
	48,262	53,630
Reserve for obsolescence	(4,628)	(4,288)
Total	$ 43,634	$ 49,342

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3. Equipment and Leasehold Improvements, net (in thousands)

	June 27, 2008	December 28, 2007
Computer equipment and software	$ 7,406	$ 6,980
Furniture and fixtures	705	622
Machinery and equipment	9,804	8,274
Leasehold improvements	14,292	8,221
	32,207	24,097
Accumulated depreciation and amortization	(11,728)	(10,002)
Total	$ 20,479	$ 14,095

4. Purchased Intangibles and Goodwill, net (in thousands)

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Weighted Average Years
June 27, 2008				
Customer list	$ 13,800	$ (2700)	$ 11,100	10.7
Tradenames	9,787	(800)	8,987	*
Total	$ 23,587	$ (3,500)	$ 20,087	
December 28, 2007				
Customer list	$ 13,800	$ (2,025)	$ 11,775	10.7
Tradenames	9,787	(800)	8,987	*
Total	$ 23,587	$ (2,825)	$ 20,762	

* Tradename associated with UCT-Sieger had an estimated life of six months and, as of December 29, 2006, had been fully amortized. Trade name associated with Ultra Clean Technology Systems and Service, Inc. has

an indefinite
life.

Amortization expense related to purchased intangibles was $0.3 million and $0.7 million during the first six months of fiscal 2008 and 2007, respectively. The total expected future amortization related to purchased intangibles will be approximately $0.7 million, $1.4 million, $1.3 million and $1.2 million in fiscal years 2008 through 2011, respectively, and $6.4 million thereafter.

The Goodwill balance as of December 28, 2007 was $34.2 million. There was no change in the carrying amount of goodwill during the six months ended June 27, 2008.

5. Borrowing Arrangements

In connection with the acquisition of Sieger in the second quarter of 2006, the Company entered into a borrowing arrangement and an equipment loan with two commercial banks. The loan agreement requires compliance with certain financial covenants, including a leverage and fixed charge coverage target. The loan agreement under the borrowing arrangement with one bank provides 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 ($10.0 million of which may be used for the issuance of letters of credit) and a $7.5 million term loan. The aggregate amount of the credit facilities is also subject to a borrowing base equal to 80% of eligible accounts receivable and is secured by substantially all of the Company s assets. Each of the credit facilities will expire on June 29, 2009 and contain certain financial covenants, including minimum profitability and liquidity ratios. As of June 27, 2008, the Company was in compliance with all loan covenants. In addition, the term loan is subject to monthly amortization payments in 36 equal installments. Interest rates on outstanding loans under the credit facilities ranged from 4.50% to 4.25% per annum during the quarter ended June 27, 2008, and were 4.25% as of June 27, 2008. The equipment loan is a 5 year, $5.0 million loan that is secured by certain equipment. The interest rate on the equipment loan was 7.6% per annum as of June 27, 2008. The combined balance outstanding on the borrowing arrangement and equipment loan at June 27, 2008 was $20.5 million, of which $3.4 million is included in other current liabilities.

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6. Stock Repurchase Plan Subsequent Event

On July 24, 2008, the Board of Directors approved a stock repurchase program for up to $10.0 million. The Company expects to commence the repurchase of its common stock immediately and complete such repurchases on or before June 30, 2009. The Company will repurchase its shares depending on market conditions, stock price and other factors. The program will be funded using the Company s existing cash balance and future cash flows. The share repurchases will occur through systematic or open market purchases as permitted by securities laws and other legal requirements.

7. Net Income (Loss) Per Share

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

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

	Three months ended		Six months ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Numerator:				
Net income (loss)	$ (162)	$ 5,096	$ 1,727	$ 10,281
Denominator:				
Shares used in computation basic:				
Weighted average common shares outstanding	21,643	21,253	21,604	21,204
Weighted average common shares outstanding subject to repurchase	( )	(17)	( )	(16)
Shares used in computing basic Net income (loss) per share	21,643	21,236	21,604	21,188
Shares used in computation diluted:				
Weighted average common shares outstanding	21,643	21,236	21,604	21,188
Dilutive effect of common shares outstanding subject to repurchase		17		16
Dilutive effect of options outstanding		792	522	808
Shares used in computing diluted Net income (loss) per share	21,643	22,045	22,126	22,012
Net income (loss) per share basic	$ (0.01)	$ 0.24	$ 0.08	$ 0.49
Net income (loss) per share diluted	$ (0.01)	$ 0.23	$ 0.08	$ 0.47

8. 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 $65,000 and $128,000 for the three and six month periods ended June 27, 2008 and $63,000 and $125,000 for the three and six month periods ended June 29, 2007, respectively.

The spouse of one of the Company s executive s 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 $60,000 and $144,000 for the three and six month periods ended June 27, 2008 and $146,000 and $215,000 for the three and six month periods ended June 29, 2007, respectively.

The sister, son and sister-in-law of one of the Company s directors either worked or continue to work for the Company. Aggregate salaries paid by the Company to the aforementioned individuals totaled $12,000 and $30,000 for the three and six month periods ended June 27, 2008 and $46,000 and $87,000 for the three and six month periods ended June 29, 2007, respectively. As of June 27, 2008, only the sister-in-law continues to work for the Company.

9. Commitments and Contingencies

The Company had commitments to purchase inventory totaling approximately $51.3 million at June 27, 2008.

Included in accrued liabilities is an estimate of $125,000, based on a range of $125,000 to $250,000, to exit previously leased facilities.

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 will receive approximately $4.1 million in tenant improvement allowances and incentives as well as $1.2 million in rent abatements over the first two years of the lease. The operating lease term for the new facility commenced on April 1, 2008, and will continue through April 1, 2015, with minimum monthly lease payments beginning at $119,000 and escalating annually after the first two years. The Company s total future minimum lease payments over the term of the lease will be approximately $10.2 million.

On September 2, 2005, the Company filed suit in the federal court for the Northern District of California against Celerity, Inc., or Celerity, seeking a declaratory judgment that our new substrate technology does not infringe certain of Celerity s patents and/or that Celerity s patents are invalid. On September 13, 2005, Celerity filed suit in the federal court of Delaware alleging that the Company infringed eight patents by developing and marketing products that use Celerity s fluid distribution technology. The Company then filed motions for summary judgments

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of non-infringement and invalidity with the Court. The Court issued summary judgment in April 2007, dismissing four of Celerity s patent infringement claims. In addition, Celerity had previously withdrawn two of its patent infringement claims. The case ultimately went to trial in June 2007, and, on June 25, 2007, a jury found that the Company did not infringe on one of the two remaining patents at issue but did infringe on the other. The jury awarded damages of $45,000 to Celerity in royalty fees for gas panel sales to date related to the product that was found to infringe the Celerity patent and enjoined the Company from making, using, or selling the product that was found to infringe the Celerity patent. The court also ordered the Company to pay Celerity $85,000 in court costs. The Company has appealed the jury verdict and injunction to the Court of Appeals for the Federal Circuit (CAFC). In addition, the Company has requested, and the United States Patent and Trademark Office (USPTO) has granted, the Company s request for re-examination of the one Celerity patent that the Company was found to infringe. The reexamination by the USPTO is pending. The Company does not expect the outcome of the appeal to the CAFC or the ruling by the USPTO in the re-examination of the Celerity patent to have a material impact on the Company s operating results or cash flows.

From time to time, we are also subject to various legal proceedings and claims, either asserted or unasserted, that arise in the ordinary course of business. Although the outcome of the above-described matter or 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.

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

The information set forth in this quarterly report on Form 10-Q contains forward-looking statements regarding future events and our future results. These statements are based on current expectations, estimates, forecasts, and projections about the industries in which we operate and the beliefs and assumptions of our management. Words such as expects, anticipates, targets, goals, projects, intends, plans, believes, seeks, estimates, continu such words, and similar expressions are intended to identify such forward-looking statements. These forward-looking statements include, but are not limited to, statements concerning the following: projections of our financial performance, our anticipated growth and trends in our businesses, levels of capital expenditures, the adequacy of our capital resources to fund operations and growth, our ability to compete effectively with our competitors, our strategies and ability to protect our intellectual property, future acquisitions, customer demand, our manufacturing and procurement process, employee matters, supplier relations, foreign operations (including our operations in China), the legal and regulatory backdrop (including environmental regulation), our exposure to market risks and other characterizations of future events or circumstances described in this Quarterly Report. Readers are cautioned that these forward-looking statements are only predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict, including those identified below, under Risk Factors, and elsewhere herein. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. We undertake no obligation to revise or update any forward-looking statements for any reason.

Overview

We are a leading developer and supplier of critical subsystems, primarily for the semiconductor capital equipment (SCE) industry. We also leverage the specialized skill sets required to support SCE to serve the technologically similar markets in the flat panel, solar and medical device 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. 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.

Our customers are primarily original equipment manufacturers. We provide our customers complete subsystem solutions that combine our expertise in design, test, component characterization and highly flexible manufacturing operations, advanced quality control programs, and the financial stability required of a reliable business partner. This combination helps us to drive down total manufacturing costs, reduce design-to-delivery cycle times and maintain high quality standards for our customers. We believe these characteristics, as well as our standing as a leading supplier of gas delivery systems and other critical subsystems, place us in a strong position to benefit from the growing demand for subsystem outsourcing.

Ultra Clean Holdings, Inc. was founded in November 2002 for the purpose of acquiring Ultra Clean Technology Systems and Service, Inc. Ultra Clean Technology Systems and Service, Inc. was founded in 1991 by Mitsubishi Corporation and was operated as a subsidiary of Mitsubishi until November 2002, when it was acquired by Ultra Clean Holdings, Inc. Ultra Clean Holdings, Inc. became a publicly traded company in March 2004. In June 2006, we completed the acquisition of Sieger Engineering, Inc., a California corporation (Sieger) and a supplier of chemical mechanical planarization modules and other subsystems to the semiconductor and flat panel capital equipment and medical device industries. Ultra Clean Technology (Shanghai) Co., Ltd and Ultra Clean Micro-Electronics Equipment (Shanghai) Co., Ltd were established in 2005 ad 2007, respectively, to faciliate our operations in China.

We have in the past considered and will continue to consider acquisitions that will enable us to expand our geographic presence, secure new customers and diversify into complementary products and markets as well as broaden our technological capabilities in semiconductor capital equipment manufacturing.

Financial Highlights

Our operating results for the three and six months ended June 27, 2008 compared to the same periods in the prior year reflects a decrease in demand of our products as a result of an overall slowdown in the semiconductor capital equipment market. Sales for the three months ended June 27, 2008 were $67.4 million, a decrease of $37.4 million, or 35.7%, from the same quarter of 2007. Gross profit in the second quarter of 2008 decreased $8.3 million, or 52.4%, to

11.2% of sales, from $15.8 million, or 15.1% of sales, in the second quarter of 2007. Total operating expenses in the second quarter of 2008 decreased to $8.2 million, or 12.2% of sales, from $8.3 million, or 7.9% of sales, compared to the second quarter of 2007. We incurred a net loss during the second quarter of 2008 of $0.2 million compared to net income of $5.1 million for the comparable period in 2007 as a result of decreased sales and gross profits earned during the current quarter and only slightly lower operating costs.

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	
	June 27, 2008	**June 29, 2007**	**June 27, 2008**	**June 29, 2007**
Sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	88.8%	84.9%	87.7%	84.9%
Gross profit	11.2%	15.1%	12.3%	15.1%
Operating expenses:				
Research and development	0.9%	0.7%	0.9%	0.8%
Sales and marketing	2.0%	1.3%	1.9%	1.3%
General and administrative	9.3%	5.9%	8.1%	5.9%
Total operating expenses	12.2%	7.9%	10.8%	8.0%

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	Three months ended		Six months ended	
	June 27, 2008	June 29, 2007	June 27, 2008	June 29, 2007
Income from operations	(1.0)%	7.2%	1.5%	7.1%
Interest and other income (expense), net	(0.4)%	(0.4)%	(0.4)%	(0.4)%
Income (loss) before provision (benefit) for income taxes	(1.4)%	6.8%	1.1%	6.7%
Income tax provision (benefit)	(0.9)%	1.9%	0.1%	1.9%
Net income (loss)	(0.4)%	4.9%	1.0%	4.8%

Sales

Sales in the second quarter of 2008 decreased $37.3 million, or 35.7%, to $67.4 million from $104.7 million in the second quarter of 2007. Sales for the six months ended June 27, 2008 decreased $55.8 million, or 25.9%, to $159.7 million for the six months ended June 29, 2007. The decrease in sales reflects a decrease in demand, primarily from our top three customers, as a result of the overall slowdown in the semiconductor capital equipment market. We expect sales to be slightly lower in the third quarter of 2008.

Historically, a relatively small number of OEM customers have accounted for a significant portion of our sales. In the three months ended June 27, 2008, three customers each accounted for 10% or more of our total sales: Applied Materials, Inc., Lam Research Corporation and Intuitive Surgical, Inc. As a group these three customers accounted for 80% of the Company s sales for the quarter ended June 27, 2008. For the six months ended June 27, 2008, two customers each accounted for 10% or more of our total sales: Applied Materials, Inc. and Lam Research Corporation. As a group these two customers accounted for 71% of the Company s sales for the six months ended June 27, 2008. For the three and six months ended June 29, 2007, three customers each accounted for 10% or more of our total sales: Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc. As a group these three customers accounted for 83% of the Company s sales for the three and six months ended June 29, 2007.

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 for the three months ended June 27, 2008 decreased to $7.5 million, or 11.2% of sales, from $15.8 million, or 15.1% of sales, for the same period in 2007. Gross profit for the six months ended June 27, 2008 decreased to $19.6 million, or 12.3% of sales, from $32.6 million, or 15.1% of sales, for the same period in 2007.

Our gross margin for the three and six month periods ended June 27, 2008 decreased from the comparable periods in 2007 due primarily to reduced capacity utilization on lower volume. We expect gross profit to decrease incrementally as a result of expected lower sales in the third quarter of 2008.

Research and Development Expense

Research and development expense consists primarily of activities related to new component testing and evaluation, test equipment and fixture development, product design, and other product development activities. Research and development expense for the second quarter of 2008 decreased $0.2 million, or 22.9%, to $0.6 million, or 0.9% of sales, compared to $0.8 million, or 0.7% of sales in the same quarter in 2007. The decrease in expense is primarily due to a decrease in headcount and other payroll related expenses.

Research and development expense for the first six months of 2008 was $1.4 million, or 0.9% of sales, compared with $1.6 million, or 0.8% of sales, for the same period of 2007. The decrease in expense is due primarily to a decrease in headcount and other payroll related expenses. The increase as a percent of sales is due to a decrease in sales in the three and six months ended June 29, 2008 compared to the same periods in the previous year.

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 second quarter of 2008 was $1.3 million, or 2.0% of sales, compared with $1.3 million, or 1.3% of sales, in the same quarter of 2007. The increase in percent of sales is due to a decrease in sales during the second quarter of 2008.

Sales and marketing expense for the first six months of 2008 was $3.0 million, or 1.9% of sales, compared with $2.8 million, or 1.3% of sales, in the same period of 2006. The increase in expense is attributable to an increase in headcount during the year. The increase in expense as a percent of sales is due to a decrease in sales during the first six months of 2008.

General and Administrative Expense

General and administrative expense consists primarily of salaries and overhead associated with our administrative staff and professional fees. General and administrative expense increased less than $0.1 million, or less than 0.1% in the second quarter of 2008 to $6.3 million, or 9.3% of sales, compared with $6.2 million, or 5.9% of sales, in the same quarter of 2007. The increase in percent of sales in the second quarter of 2008 is due to a decrease in sales compared to the same period of 2007.

General and administrative expense increased $0.1 million, or less than 1.0%, in the first six months of 2008 to $12.9 million, or 8.1% of sales, compared with $12.8 million, or 5.9% of sales, in the same period of 2007. The increase in percent of sales for the first six months of 2008 is due to a decrease in sales compared to the same period of 2007.

Interest and Other Income (Expense), net

Interest and other income (expense), net for the second quarter of 2008 was $(0.2) million compared to $(0.5) million in the second quarter of 2007. The decrease in net expense for the three months ended June 27, 2008 is primarily attributable to a combination of

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lower debt due to principal reductions and lower interest rates due to market fluctuations compared to the second quarter of 2007.

Interest and other income (expense), net for the first six months of 2008 was $(0.6) million compared to $(1.0) million in the same period of 2007. The decrease in net expense for the six months of 2008 is primarily attributable to a combination of lower debt and related interest rates experienced since the second quarter of 2007.

Income Tax Provision

Our effective tax rate for the first six months of 2008 was 1.8% compared to 26.8% for the year ended December 28, 2007. The decrease in 2008 reflects, primarily, a change in the geographic mix of worldwide earnings and financial results for 2008 compared with fiscal year 2007.

Liquidity and Capital Resources

With the exception of the Sieger acquisition, which was funded by third-party debt, historically, we have required capital principally to fund our working capital needs, satisfy our debt obligations, maintain our equipment and purchase new capital equipment. As of June 27, 2008, we had cash of $32.6 million compared to $33.4 million as of December 28, 2007.

For the six months ended June 27, 2008 we generated cash from operating activities of $7.9 million compared to cash generated of $1.0 million for the six months ended June 29, 2007, reflecting an increase of $6.9 million. Cash flow during the first six months of 2008 was favorably impacted by net income, depreciation and amortization and stock-based compensation of $1.7 million, $2.4 million and $1.9 million, respectively, decreases in accounts receivable of $8.2 million, inventory of $5.7 million, and accrued compensation benefits of $0.6 million, offset by decreases in accounts payable of $14.3 million and other liabilities of $4.3 million.

Net cash used in investing activities for the six months ended June, 2008 was $8.1 million compared to net cash used of $3.1 million for the comparable period of 2007, reflecting an increase in cash used of $5.0 million. The increase in cash used was due primarily to higher levels of capital expenditures relating to leasehold and capital equipment in our new facility in Hayward, California as well as for our second manufacturing facility in Shanghai, China. In addition to our normal general capital expenditures, we expect to invest approximately $0.9 million in our new Hayward facility during the remainder of fiscal 2008 and approximately $2.1 million in our new Shanghai facility over the next four years. Cash for these investments will be provided from existing cash and cash from operations.

Net cash used in financing activities for the six months ended June 27, 2008 decreased $0.6 million to net cash used of $0.7 million from $1.3 million used in financing activities for the six months ended June 29, 2007. During the first six of fiscal 2008 cash was used primarily to pay back long term debt offset by proceeds from the issuance of common stock from our employee stock compensation plans.

We anticipate that our operating cash flow, together with available borrowings under our revolving credit facility, will be sufficient to meet our working capital requirements, capital lease obligations, expansion plans 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 cyclical expansion or contraction of the semiconductor capital equipment industry 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 real estate, 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 as of June 27, 2008 (in thousands):

	Remainder of 2008	2009	2010	2011	2012	2013	Total
Capital Lease	$ 17	$ 3	$	$	$	$	$ 20
Operating Lease (1)	920	2,404	1,867	1,817	1,944	4,329	13,281
Borrowing arrangements	1,900	17,185	1,008	443			20,536

Total (2)	$ 2,837	$ 19,592	$ 2,875	$ 2,260	$ 1,944	$ 4,329	$ 33,837

(1) Operating lease expense reflects (a) the lease for our new headquarters facility in Hayward, California; (b) the lease for a manufacturing facility in Portland, Oregon expires on October 31, 2010; (c) the leases for manufacturing facilities in South San Francisco expire in 2008, 2009 and 2010; (d) two leases for manufacturing facilities in Austin, Texas that expire on August 31, 2009. We have options to renew certain of the leases in South San Francisco, which we expect to exercise.

(2) We adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48), on

December 30, 2006. As of June 27, 2008, we have recorded a tax liability of $796,000 to offset the recognition of previously recorded excess tax benefits. Because of the uncertainty surrounding the future payment of these liabilities, the amounts have been excluded from the table above.

Critical Accounting Policies, Significant Judgments and Estimates

Our condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, which requires management to make estimates and judgments that affect the reported amounts of assets,

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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.

Revenue Recognition

Revenue Recognition Our revenue is concentrated in a few OEM customers in the semiconductor capital equipment and flat panel display industry. Our standard arrangement for our customers includes a signed purchase order or contract, no right of return of delivered products and no customer acceptance provisions. Revenue from sales of products is recognized when:

we enter into a legally binding arrangement with a customer;

we ship the products;

price is deemed fixed or determinable;

product delivery is deemed free of contingencies or significant uncertainties; and

collection is reasonably assured.

Revenue is generally recognized upon shipment of the product. In arrangements which specify title transfer upon delivery, revenue is not recognized until the product is delivered. In addition, if we have not substantially completed a product or fulfilled the terms of the agreement at the time of shipment, revenue recognition is deferred until completion. Determination of criteria in the fourth and fifth bullet points above is based on our judgment regarding products we may deliver with contingencies or significant uncertainties and the collectability of those amounts. We defer revenue for product that we may deliver to a customer that is missing a critical component or requires customer testing.

We assess collectability based on the credit worthiness of the customer and past transaction history. We perform on-going credit evaluations of customers and do not require collateral from our customers. We have not experienced significant collection losses in the past. A significant change in the liquidity or financial position of any one customer could make it more difficult for us to assess collectability.

Inventory Valuation

We value the majority of our inventories at the lesser of standard cost, determined on a first-in, first-out basis, or market. We value inventory from our subsidiary, UCT-Sieger, at the lesser of actual cost or market. We assess the valuation of all inventories, including raw materials, work-in-process, finished goods and spare parts on a periodic basis. Obsolete inventory or inventory in excess of our estimated usage is written-down to its estimated market value less costs to sell, if less than its cost. The inventory write-downs are recorded as an inventory valuation allowance established on the basis of obsolete inventory or specific identified inventory in excess of estimated usage. Inherent in our estimates of market value in determining inventory valuation are estimates related to economic trends, future demand for our products and technological obsolescence of our products. If actual market conditions are less favorable than our projections, additional inventory write-downs may be required. If the inventory value is written down to its net realizable value, and subsequently there is an increased demand for the inventory at a higher value, the increased value of the inventory is not realized until the inventory is sold either as a component of a subsystem or as separate inventory.

Accounting for Income Taxes

The determination of our tax provision and measurement of current taxes payable or refundable and deferred tax assets and liabilities requires that we make certain judgments and estimates. Changes to these estimates or a change in judgement may have a material impact on our Company s tax provision in a future period. 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. We have not recorded any valuation allowance to impair our tax assets because, based on the available evidence, we believe it is more likely than not that we will be able to utilize all of our deferred tax assets in the future. If we do not generate sufficient future income, the realization of these deferred tax assets may be impaired, resulting in an additional income tax expense.

On December 30, 2006, we adopted the provision of Financial Accounting Standards Board (FASB) Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), which clarifies the accounting for uncertainty in income tax positions. This Interpretation requires that we recognize in the condensed consolidated financial statements the impact of a tax position that is more likely than not to be sustained upon examination based on the technical merits of the position. The benefit of a tax position is recognized in the financial statements in the period during which, based on all available evidence, management believes it is more likely than not that the position will be sustained upon examination, including the resolution of appeals or litigation processes, if any. The portion of the benefits associated with tax positions taken that exceeds the amount measured as described above is reflected as a liability for recognized tax benefits in the accompanying balance sheets along with any associated interest that would be payable to the taxing authorities upon examination.

Business Combinations

In accordance with business combination accounting, we allocate the purchase price of acquired companies to the tangible and intangible assets acquired and liabilities assumed based on their estimated fair values. The Company s management estimates the fair value and may consult with a third-party specialist to assist management in determining the fair values of acquired intangible assets

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such as trade name and customer relationships. Such valuations require management to make significant estimates and assumptions. Management makes estimates of fair value based upon assumptions believed to be reasonable. These estimates are based on historical experience and information obtained from the management of the acquired companies and are inherently uncertain.

Valuation of Intangible Assets and Goodwill

We periodically evaluate our intangible assets and goodwill in accordance with Statement of Financial Accounting Standards No. 142 (SFAS No. 142), *Goodwill and Other Intangible Assets* , for indications of impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Intangible assets include goodwill, customer lists and tradename. Factors we consider important that could trigger an impairment review include significant under-performance relative to historical or projected future operating results, significant changes in the manner of our use of the acquired assets or the strategy for our overall business, or significant negative industry or economic trends. The provisions of SFAS No. 142 also require a goodwill impairment test annually or more frequently if impairment indicators arise. In testing for a potential impairment of goodwill, the provisions of SFAS No. 142 require the application of a fair value based test at the reporting unit level. We operate in one segment and have one reporting unit. Therefore, all goodwill is considered enterprise goodwill and the first step of the impairment test prescribed by SFAS No. 142 requires a comparison of our fair value to our book value. If the estimated fair value is less than the book value, SFAS No. 142 requires an estimate of the fair value of all identifiable assets and liabilities of the business, in a manner similar to a purchase price allocation for an acquired business. This estimate requires valuations of certain internally generated and unrecognized intangible assets such as in-process research and development and developed technology. Potential goodwill impairment is measured based upon this two-step process. We performed the annual goodwill impairment test as of December 28, 2007 and determined that goodwill was not impaired.

Equity Incentives to Employees

We account for our employee stock purchase plan (ESPP) and employee stock-based compensation plan in accordance with the provisions of Statement of Financial Account Standards 123(R) *Accounting for Stock-Based Compensation,* (SFAS 123(R)), which requires recognition of the fair value of stock-based compensation. The fair value of stock options was estimated using a Black-Scholes option valuation model. This methodology requires the use of subjective assumptions in implementing SFAS 123(R), including expected stock price volatility and the estimated life of each award. The fair value of stock-based compensation awards less the estimated forfeitures is amortized over the service period of the award, and we have elected to use the straight-line method. We make quarterly assessments of the adequacy of the tax credit pool to determine if there are any deficiencies that require recognition in the consolidated income statements.

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 a financial instrument caused by fluctuations in interest rates, foreign exchange rates or equity prices.

Foreign Exchange Rates

We do not make material sales in currencies other than the United States Dollar or have material purchase obligations outside of the United States, except in China where we have purchase commitments totaling $6.8 million in United States Dollar equivalents. We have performed a sensitivity analysis assuming a hypothetical 10-percent movement in foreign currency exchange rates applied to the underlying exposure described above. As of June 27, 2008, the analysis indicated that such market movements would not have a material effect on our business, financial condition or results of operations. Although we do not anticipate any significant fluctuations, there can be no assurance that foreign currency exchange risk will not have a material impact on our financial position, results of operations or cash flow in the future.

Interest Rates

Our interest rate risk relates primarily to our third party debt which totals $20.5 million as of June 27, 2008, 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 $0.1 million 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 $0.1 million per quarter. This would be partially offset by decreased interest income on our invested cash.

ITEM 4. Controls and Procedures

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act), management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this report in ensuring that information required to be disclosed was recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission s rules and forms, and to provide reasonable assurance that information required to be disclosed by us in such reports is accumulated and communicated to management, including our Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

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. Based on that evaluation, there has been no such change during the fiscal quarter.

It should be noted that 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.

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PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

On September 2, 2005, we filed suit in the federal court for the Northern District of California against Celerity, Inc., or Celerity, seeking a declaratory judgment that our new substrate technology does not infringe certain of Celerity s patents and/or that Celerity s patents are invalid. On September 13, 2005, Celerity filed suit in the federal court of Delaware alleging that we have infringed eight patents by developing and marketing products that use Celerity s fluid distribution technology. We then filed motions for summary judgments of non-infringement and invalidity with the Court. The Court issued summary judgment in April 2007, dismissing four of Celerity s patent infringement claims. In addition, Celerity had previously withdrawn two of its patent infringement claims. The case ultimately went to trial in June 2007, and, on June 25, 2007, a jury found that we did not infringe on one of the two remaining patents at issue but did infringe on the other. The jury awarded damages of $45,000 to Celerity in royalty fees for gas panel sales to date related to the product that was found to infringe the Celerity patent and enjoined us from making, using, or selling the product that was found to infringe the Celerity patent. The court also ordered us to pay Celerity $85,000 in court costs. We have appealed the jury verdict and injunction to the Court of Appeals for the Federal Circuit (CAFC). In addition, we have requested, and the United States Patent and Trademark Office (USPTO) has granted, our request for re-examination of the one Celerity patent that we were found to infringe. The reexamination by the USPTO is pending. We do not expect the outcome of the appeal to the CAFC or the ruling by the USPTO in the re-examination of the Celerity patent to have a material impact on our operating results or cash flows.

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

ITEM 1A. Risk Factors

The highly cyclical nature of the semiconductor capital equipment industry and general economic slowdowns could harm our operating results.

Our business and operating results depend in significant part upon capital expenditures by manufacturers of semiconductors, which in turn depend upon the current and anticipated market demand for semiconductors. Historically, the semiconductor industry has been highly cyclical, with recurring periods of over-supply of semiconductor products that have had a severe negative effect on the demand for capital equipment used to manufacture semiconductors. We have experienced and anticipate that we will continue to experience significant fluctuations in customer orders for our products. Our sales were $160.0 million for the first six months of fiscal 2008 compared to $216.0 million for the comparative period in fiscal 2007. Historically, semiconductor industry slowdowns have had, and future slowdowns may have, a material adverse effect on our operating results.

In addition, uncertainty regarding the growth rate of economies throughout the world has from time to time caused companies to reduce capital investment and may in the future cause reduction of such investments. These reductions have often been particularly severe in the semiconductor capital equipment industry.

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

A relatively small number of OEM customers have historically accounted for a significant portion of our sales, and we expect this trend to continue. Collectively, Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc., have accounted for 83%, 86% and 89% of our sales in fiscal years 2007, 2006 and 2005, respectively. Because of the small number of OEMs in our industry, 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. 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 might experience business disruptions and unanticipated expenses associated with the relocation of our headquarters to a new facility.

We entered into a new lease in Hayward, California, to consolidate our Menlo Park operations and certain South San Francisco manufacturing operations and we have already moved a substantial part of those operations into the new facility during the second and third quarters of 2008. We have incurred and will continue to incur moving expenses and could experience disruptions in our operations relating to the move, either of which could be material. We may not have anticipated all the logistical impediments and obstacles and may incur unanticipated delays in the manufacture of our products and expenses related to the remaining stages of our move, which could adversely affect our financial condition and results of operation.

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We have experienced and may continue to experience difficulties with our new enterprise resource planning (ERP) system, which we implemented during the fourth quarter of fiscal 2007, and which has impacted and could further impact our results of operation.

We have experienced and may continue to experience, difficulties with our new ERP system. For example, in the fourth quarter of fiscal 2007, increased year-end rescheduling actions by our customers, combined with the difficulties we experienced with our new ERP system, resulted in inefficiencies which drove higher operating costs. We plan to implement our new ERP system in our China facilities during the first quarter of fiscal 2009. Difficulties related to implementing and working with a new ERP system have adversely effected and could disrupt our ability to timely and accurately process and report key components of the results of a consolidated operations, our financial position and cash flows. Any disruptions or difficulties that may occur in connection with this new ERP system could further adversely affect our ability to complete the evaluation of our internal controls and attestation activities required by SOX 404. System failure or malfunctioning may result in disruption of operations and the inability to process transactions and could adversely affect our financial results.

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

We are expanding our operations in China. Total assets in China at June 27, 2008 and December 28, 2007 were $31.8 million and $27.0 million, respectively.

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

foreign currency exchange fluctuations;

political, civil and economic instability;

tariffs and other barriers;

timing and availability of export licenses;

disruptions to our and our customers operations due to the outbreak of communicable diseases, such as SARS and avian flu;

disruptions in operations due to the weakness of China s domestic infrastructure, including transportation and energy;

difficulties in developing relationships with local suppliers;

difficulties in attracting new international customers;

difficulties in accounts receivable collections;

difficulties in staffing and managing a distant international subsidiary and branch operations;

the burden of complying with foreign and international laws and treaties;

difficulty in transferring funds to other geographic locations;

potentially adverse tax consequences; and,

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

us to fines or penalties.

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

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 semiconductor industry or otherwise, often resulting in reduced sales during industry downturns and increased sales during periods of industry recovery;

changes in the timing and size of orders by our customers;

cancellations and postponements of previously placed orders;

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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.

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. For example, in 2007 we completed our defense of an infringement action brought against us by Celerity, Inc. Our defense was successful only in part. We have incurred a total of approximately $130,000 in damages and court costs related to the Celerity infringement. In addition, we may be unaware of intellectual property rights of others that may be applicable to our products. Any litigation regarding patents or other intellectual property could be costly and time-consuming and divert our management and key personnel from our business operations, any of which could have a material adverse effect on our business and results of operations. The complexity of the technology involved in our products and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement may also require us to enter into costly license agreements. However, we may not be able to obtain licenses on terms acceptable to us, or at all. We also may be subject to significant damages or injunctions against the development, manufacture and sale of certain of our products if any such claims prove successful.

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

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

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customer specifications, we could incur excess or obsolete inventory charges. These risks are even greater as we expand our business beyond gas delivery systems into new subsystems. As a result, 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 affect 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 manage our future growth successfully.

Our ability to execute our business plan successfully in a rapidly evolving market requires an effective planning and management process. We have increased, and plan to continue to increase, the scope of our operations. Our revenues in 2007 increased 19.7% over revenues in 2006, and our 2006 revenues increased 128.6% over our 2005 revenues, in significant part due to the acquisition of Sieger. However, in the second quarter of 2008, revenue decreased 27.1 % compared to revenue in the first quarter of 2008 and 35.7% compared to the second quarter of fiscal 2007. Due to the cyclical nature of the semiconductor industry, future growth is difficult to predict. Our expansion efforts could be expensive and may strain our managerial and other resources. To manage future growth effectively, we must maintain and enhance our financial and operating systems and controls and manage expanded operations. Although we occasionally experience reductions in force, over time the number of people we employ has generally grown and we expect this number to continue to grow when our operations expand. The addition and training of new employees may lead to short-term quality control problems and place increased demands on our management and experienced personnel. If we do not manage growth properly, 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.

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 semiconductor industry and with technological innovation generally, our products may not be competitive.

Rapid technological innovation in semiconductor manufacturing requires the semiconductor capital equipment industry to anticipate and respond quickly to evolving customer requirements and could render our current product offerings and technology

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

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

- design innovative and performance-enhancing features that differentiate our products from those of our competitors;
- identify emerging technological trends in the semiconductor industry, 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 industry in which we participate is highly competitive and rapidly evolving, and if we are unable to compete effectively, our operating results would be harmed.

Our competitors are primarily companies that design and manufacture critical subsystems for semiconductor capital equipment. Although we have not faced competition in the past from the largest subsystem and component manufacturers in the semiconductor capital equipment industry, 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 semiconductor 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 semiconductor capital equipment, it will likely continue to be incorporated into that piece of equipment for at least several months before the OEM switches to the product of another supplier. Accordingly, it is important that our products are designed into the new semiconductor 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 semiconductor capital equipment. Further, developing new customer relationships, as well as increasing our market share at existing customers, requires a substantial investment of our sales, engineering and management resources without any assurance from prospective customers that they will place significant orders. We believe that OEMs often select their suppliers and place orders based on long-term relationships. Accordingly, we may have difficulty achieving design wins from OEMs that are not currently our customers. Our operating results and potential growth could be adversely affected if we fail to achieve design wins with leading OEMs.

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

Demand shifts in the semiconductor industry 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;

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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.

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 semiconductor 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 some of 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 June 27, 2008, our long-term debt was $17.1 million and our short-term debt was $3.4 million, for an aggregate total of $20.5 million. Our loan agreement requires compliance with certain financial covenants, including a leverage and fixed charge coverage test. 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;

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make payments on our other debt, other than in the ordinary course; and

engage in certain mergers and acquisitions.

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

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.

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 $8.1 million during the first six months of 2008, of which $6.2 million related to improvements of our new manufacturing facility in Hayward, California and $0.9 million related to the development of our manufacturing facilities in China. In 2007, we made capital expenditures of $8.0 million, of which $4.3 million related to the implementation of our new ERP system and $1.7 million related to the development of our manufacturing facilities in China, which includes $1.5 million related to our second, recently leased manufacturing facility in Shanghai, China. We expect to invest approximately $3.0 million in these facilities over the next four years. The amount of our future capital requirements will depend on many factors, including:

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 currently have a credit facility, 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. Our loan agreement with our credit facility terminates on June 29, 2009 and we may not be able renew it on favorable terms. Future equity financings could be dilutive to holders of our common stock, and debt financings could 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.

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

Our international sales are denominated primarily, though not entirely, in U.S. dollars. Many of the costs and expenses associated with our Chinese subsidiaries are paid in Chinese Renminbi, and we expect our exposure to Chinese Renminbi to increase as we ramp up production in those facilities. In addition, purchases of some of our

components are denominated in Japanese Yen. Changes in exchange rates among other currencies in which our revenue or costs are denominated and the U.S. dollar may affect our revenue, cost of sales and operating margins. While fluctuations in the value of our revenue, cost of sales and operating margins as measured in U.S. dollars have not materially affected our results of operations historically, we do not currently hedge our exchange exposure, and exchange rate fluctuations could have an adverse effect on our financial condition and results of operations in the future.

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

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

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

Our facilities could be subject to a catastrophic loss caused by natural disasters, including fires and earthquakes. We have facilities in areas with above average seismic activity, such as our manufacturing facility in South San Francisco, California, our manufacturing and headquarters facilities in Menlo Park, California and our new 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 in South San Francisco, Menlo Park and our new facility in Hayward, California. We do not carry insurance policies that cover potential losses caused by earthquakes or other natural disasters or power loss.

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

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

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.

Provisions of our charter documents could discourage potential acquisition proposals and could delay, deter or prevent a change in control.

The provisions of our amended and restated certificate of incorporation and bylaws could deter, delay or prevent a third party from acquiring us, even if doing so would benefit our stockholders. These provisions include:

- a requirement that special meetings of stockholders may be called only by our board of directors, the chairman of our board of directors, our president or our secretary;
- advance notice requirements for stockholder proposals and director nominations; and
- the authority of our board of directors to issue, without stockholder approval, preferred stock with such terms as our Board of Directors may determine.

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

None.

ITEM 3. Defaults Upon Senior Securities

None.

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

We held our Annual Meeting of Stockholders on June 5, 2008. At the meeting, our stockholders voted on the following two proposals and cast their votes as follows to approve such proposals:

Proposal 1: The stockholders elected each of the following persons as a director to hold office until our 2008 Annual Meeting of Stockholders or until such director s earlier retirement, resignation or removal:

Director s Name	Votes For	Votes Withheld
Brian R. Bachman	18,600,068	221,303
Susan H. Billat	18,715,708	105,663
Kevin C. Eichler	18,713,456	107,915
Clarence L. Granger	18,608,184	213,187
David T. ibnAle	9,126,531	9,694,840
Leonid Mezhvinsky	18,554,299	267,072

Proposal 2: Stockholders ratified the appointment of Deloitte & Touche LLP as our independent registered public accounting firm for the fiscal year ending December 26, 2008 with 18,787,640 affirmative votes, 27,974 negative votes and 5,757 votes abstaining.

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ITEM 5. Other Information

None.

ITEM 6. Exhibits

(a) Exhibits

The following exhibits are filed with this current Report on Form 10-Q for the quarter ended June 27, 2008:

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.

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SIGNATURES

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

ULTRA CLEAN HOLDINGS, INC.
(Registrant)

Date: August 6, 2008

By: /s/ Clarence L. Granger

Name: Clarence L. Granger
Title: Chairman and Chief Executive Officer
(Principal Executive Officer)

Date: August 6, 2008

By: /s/ Jack Sexton

Name: Jack Sexton
Title: Chief Financial Officer
(Principal Financial Officer)

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Exhibit Index

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.