ULTRA CLEAN HOLDINGS INC
Form 10-Q
August 14, 2006

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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 30, 2006**

**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.)* |
| **150 Independence Drive, Menlo Park, California** | **94025-1136** |
| *(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, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer þ

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, 2006: 20,808,362.

**ULTRA CLEAN HOLDINGS, INC.**
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**PART I. FINANCIAL INFORMATION**
**Item 1.** ***Financial Statements***

**ULTRA CLEAN HOLDINGS, INC.**
**CONDENSED CONSOLIDATED BALANCE SHEETS**
(Unaudited; in thousands, except share and per share amounts)

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 18,958 | $ 10,663 |
| Accounts receivable | 51,982 | 19,528 |
| Inventory | 45,105 | 19,106 |
| Deferred income taxes | 2,255 | 2,294 |
| Prepaid expenses and other | 2,619 | 1,672 |
| Total current assets | 120,919 | 53,263 |
| Equipment and leasehold improvements, net | 7,856 | 4,312 |
| Goodwill | 31,857 | 6,084 |
| Intangible assets | 23,587 | 8,987 |
| Deferred income taxes | 2,132 | 2,132 |
| Other non-current assets | 331 | 231 |
| Total assets | $ 186,682 | $ 75,009 |
| **LIABILITIES & STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Bank borrowings | $ 6,172 | $ 2,343 |
| Accounts payable | 44,319 | 14,188 |
| Accrued compensation and related benefits | 3,274 | 769 |
| Other accrued expenses and liabilities | 4,600 | 2,004 |
| Capital lease obligations, current portion | 57 | 70 |
| Total current liabilities | 58,422 | 19,374 |
| Long-term debt | 28,589 | |
| Deferred tax liability | 5,723 | |
| Capital lease obligations and other liabilities | 325 | 354 |
| Total liabilities | 93,059 | 19,728 |
| Commitments and contingencies (see Note 8) | | |
| Stockholders Equity: | | |
| Preferred stock $0.001 par value, 10,000,000 authorized; none outstanding | | |
| Common stock $0.001 par value, 90,000,000 authorized; 20,800,446 and 16,501,363 shares issued and outstanding, in 2006 and 2005, respectively | 78,723 | 46,819 |
| Deferred stock-based compensation | | (350) |

| | | |
|---|---|---|
| Retained earnings | 14,900 | 8,812 |
| Total stockholders equity | 93,623 | 55,281 |
| Total liabilities and stockholders equity | $ 186,682 | $ 75,009 |

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 June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Net Sales | $ 68,469 | $ 39,289 | $ 125,664 | $ 81,214 |
| Cost of goods sold | 57,759 | 33,698 | 106,763 | 68,974 |
| Gross profit | 10,710 | 5,591 | 18,901 | 12,240 |
| Operating expenses: | | | | |
| Research and development | 733 | 749 | 1,331 | 1,436 |
| Sales and marketing | 1,124 | 864 | 2,080 | 1,758 |
| General and administrative | 3,638 | 2,860 | 6,527 | 6,223 |
| Total operating expenses | 5,495 | 4,473 | 9,938 | 9,417 |
| Income from operations | 5,215 | 1,118 | 8,963 | 2,823 |
| Interest and other income (expense), net | (36) | 28 | (523) | 55 |
| Income before income taxes | 5,179 | 1,146 | 8,440 | 2,878 |
| Income tax provision | 1,222 | 454 | 2,352 | 992 |
| Net income | $ 3,957 | $ 692 | $ 6,088 | $ 1,886 |
| Net income per share: | | | | |
| Basic | $ 0.22 | $ 0.04 | $ 0.35 | $ 0.12 |
| Diluted | $ 0.21 | $ 0.04 | $ 0.33 | $ 0.11 |
| Shares used in computing net income per share: | | | | |
| Basic | 18,250 | 16,217 | 17,566 | 16,203 |
| Diluted | 19,168 | 17,227 | 18,502 | 17,116 |

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 30, 2006 | 2005 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $ 6,088 | $ 1,886 |
| Adjustments to reconcile net income to net cash used in operating activities: | | |
| Depreciation and amortization | 950 | 1,069 |
| Loss on sale of equipment and leasehold improvements | | 30 |
| Amortization of stock-based compensation | 729 | 105 |
| Excess tax benefit from stock-based arrangements | (597) | 33 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (18,762) | (3,385) |
| Inventory | (12,032) | 1,630 |
| Deferred income taxes, net | 39 | |
| Prepaid expenses and other | (570) | 473 |
| Other non-current assets | (33) | (50) |
| Accounts payable | 16,461 | (3,776) |
| Accrued compensation and related benefits | 2,505 | (546) |
| Other accrued expenses and liabilities | (499) | 478 |
| Net cash used in operating activities | (5,721) | (2,053) |
| Cash flows from investing activities: | | |
| Purchases of equipment and leasehold improvements | (1,013) | (650) |
| Proceeds from sale of equipment and leasehold improvements | | 9 |
| Net cash used in acquisition | (27,606) | |
| Net cash used in investing activities | (28,619) | (641) |
| Cash flows from financing activities: | | |
| Principal payments on capital lease obligations | (29) | (40) |
| Proceeds from bank borrowings | 31,212 | 2,326 |
| Excess tax benefit from stock-based arrangements | 597 | |
| Proceeds from issuance of common stock | 10,855 | 260 |
| Net cash provided by financing activities | 42,635 | 2,546 |
| Net increase (decrease) in cash | 8,295 | (148) |
| Cash and cash equivalents at beginning of period | 10,663 | 11,440 |
| Cash and cash equivalents at end of period | $ 18,958 | $ 11,292 |
| Supplemental cash flow information: | | |
| Income taxes paid | $ 1,750 | $ |
| Interest paid | $ 106 | $ 22 |

| | | | | |
|---|---|---|---|---|
| Non-cash investing and financing activities: | | | | |
| Common stock issued in acquisition | $ | 20,072 | $ | |

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 for the semiconductor capital equipment industry, producing primarily gas delivery systems and other subsystems, including frame and top plate assemblies and process modules. The Company s products improve efficiency and reduce the costs of our customers design and manufacturing processes. The Company s customers are primarily original equipment manufacturers ( OEMs ) of semiconductor capital equipment. On June 29, 2006, we completed the acquisition of Sieger Engineering, Inc. ( Sieger ) which was renamed UCT Sieger Engineering LLC ( UCT Sieger ).

*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 31, 2005 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 presentation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company bases its estimates on experience and on 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.

The unaudited condensed consolidated financial statements should be read in conjunction with the Company s audited consolidated financial statements for the fiscal year ended December 31, 2005, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission on February 28, 2006. The Company s results of operations for the three and six months ended June 30, 2006 are not necessarily indicative of the results to be expected for any future periods.

*Concentration of Credit Risk* Financial instruments that subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company sells its products to U.S.-based semiconductor capital equipment manufacturers. 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% or more of total sales during the quarter: Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc. As a group these three customers accounted for 91% and 90% of the Company s sales for the three and six months ended June 30, 2006 and 2005, respectively.

*Fiscal Year* The Company uses a 52-53 week fiscal year ending on the Friday nearest December 31. For presentation purposes, the Company presents each fiscal period as if it ended on the last day of the month. All references to quarters refer to fiscal quarters.

*Comprehensive Income* In accordance with SFAS No. 130, Reporting Comprehensive Income , the Company reports the change in its net assets during the period from non-owner sources by major components and as a single total. Comprehensive income for the three and six month periods ended June 30, 2006 and 2005, respectively, was the same as net income.

*Income Taxes* In June 2006, the Financial Accounting Standards Board ( FASB ) issued 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 the Company recognize in the 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 provisions of FIN 48 will be effective as of the beginning of the Company s 2007 fiscal year, with the cumulative effect of the change in accounting principle

recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

*Inventory Costs* In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs ( SFAS 151 ), an amendment of Accounting Research Bulletin No. 43, Chapter 4. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. We adopted the provisions of SFAS 151 on January 1, 2006 and the adoption did not have a material effect on our consolidated results of operations or financial position.

*Stock-Based Compensation* On January 1, 2006 the Company implemented the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payments ( SFAS 123(R) ), using the modified prospective transition method. SFAS 123(R) requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based upon the grant-date fair value of those awards. Using the modified prospective transition method of adopting SFAS 123(R), the Company began recognizing compensation expense for equity-based awards granted after January 1, 2006 plus unvested awards granted prior to January 1, 2006. Under this method of implementation, no restatement of prior periods has been made.

Equity-based compensation expense from stock options and the related income tax benefit from the expense recognized under SFAS 123(R) was $343,000 and $106,000, respectively, for the three months ended June 30, 2006 and $629,000 and $195,000, respectively, for the six months ended June 30, 2006. The estimated fair value of the Company s equity-based awards, less expected forfeitures, is amortized over the awards vesting period on a straight-line basis. The implementation of SFAS 123(R) reduced basic and fully diluted earnings per share by $0.01 and $0.02 for the three and six months ended June 20, 2006, respectively.

The following table shows total stock-based compensation expense included in the Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2006 (in thousands):

| | Three Months Ended June 30, 2006 | Six Months Ended June 30, 2006 |
|---|---|---|
| Cost of sales | $ 92 | $ 163 |
| Research and development | 19 | 34 |
| Sales and marketing | 26 | 48 |
| General and administrative | 206 | 384 |
| Subtotal | 343 | 629 |
| Income tax benefit | (106) | (195) |
| Total stock-based compensation expense | $ 237 | $ 434 |

At June 30, 2006, the total compensation cost related to unvested stock-based awards granted to employees under the Company s stock option plans but not yet recognized was approximately $3.4 million, net of estimated forfeitures of $1.0 million. This cost will be amortized on a straight-line basis over a weighted-average period of approximately 1.4 years and will be adjusted for subsequent changes in estimated forfeitures and future option grants.

Prior to the adoption of SFAS 123(R), we presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in our statement of cash flows. In accordance with SFAS 123(R), the cash flows resulting from excess tax benefits (tax benefits related to the excess of proceeds from employee s exercises of stock options over the stock-based compensation cost recognized for those options) are classified as financing cash flows. During the three and six months ended June 30, 2006, we recorded $0.1 million and $0.6 million, respectively, of excess tax benefits as a financing cash inflow.

Prior to January 1, 2006, the Company measured compensation expense for its employee equity-based compensation plans using the intrinsic value method under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees ( APB No. 25 ) and related interpretations. As the exercise price of all options granted

under these plans was based on the fair market price of the underlying common stock on the grant date, no equity-based compensation cost was recognized in the condensed consolidated statements of operations under the intrinsic value method.

The exercise price of each stock option equals the market price of the Company s stock on the date of grant. 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 June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Dividend yield | 0% | 0% | 0% | 0% |
| Expected volatility | 50.0% | 57.7% | 50.0% | 58.1% |
| Risk-free interest rate | 5.0% | 3.8% | 4.9% | 3.8% |
| Forfeiture rate | 12.0% | | 12.0% | |
| Expected life (in years) | 4.9 | 5.0 | 4.9 | 5.0 |

The weighted average estimated fair value of employee stock option grants for the three and six months ended June 30, 2006 was $4.28 and $4.32, respectively. The weighted average estimated fair value of employee stock option grants for the three and six months ended June 30, 2005 was $3.53. The computation of the expected volatility assumption used in the Black-Scholes calculations for new grants is based on a combination of our 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 our employee stock options. We do not currently pay dividends and have no plans to do so in the future. The forfeiture rate is based on our 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.

A summary of the changes in stock options outstanding under the Company s equity-based compensation plans (in thousands, except per share amounts) is presented below:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (Years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Options outstanding at December 31, 2005 | 2,120 | $ 4.17 | 8.26 | $ 6,546 |
| Granted | 377 | 8.83 | | |
| Exercised | (227) | 1.47 | | |
| Canceled | (16) | 2.69 | | |
| Options outstanding at June 30, 2006 | 2,254 | 5.23 | 8.21 | 7,991 |
| Options exercisable at June 30, 2006 | 932 | $ 3.25 | 7.35 | $ 5,129 |

For the three and six months ended June 30, 2005, the weighted average estimated fair value of employee purchase rights granted under the Employee Stock Purchase Plan was $1.98. The following weighted average assumptions are included in the estimated grant date fair value calculations for rights to purchase stock under the Employee Stock Purchase Plan: (i) an expected dividend yield of 0%, (ii) an expected stock price volatility of 47.3%, (iii) a risk-free interest rate of 3.0% and (iv) an expected life of 0.5 years. The Company s calculations are based on the single option valuation approach, and forfeitures are recognized as they occur.

The following table summarizes our restricted stock award activity for the six months ended June 30, 2006 (in thousands):

| | Weighted Average Grant Date Fair Value |
|---|---|

| | Number of Shares |
|---|---|
| Nonvested stock at January 1, 2006 | 103 |
| Granted | |
| Vested | (16) |
| Forfeited | (2) |
| Nonvested at June 30, 2006 | 85 |

The following table illustrates the effect on net income and net income per share as if we had applied the fair value recognition provisions of SFAS 123 *Accounting for Stock-Based Compensation* as amended by SFAS No. 148 *Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FASB Statement No. 123* to stock-based compensation during the three and six months period ended June 30, 2005 (in thousands, except per share amounts):

| | Three Months Ended June 30, 2005 | Six Months Ended June 30, 2005 |
|---|---|---|
| Net income as reported | $ 692 | $ 1,886 |
| Add: stock-based employee compensation included in reported net income, net of tax | 36 | 72 |
| Less: total stock-based compensation determined under the fair value-based method for all awards, net of tax | (187) | (219) |
| Pro forma net income | $ 541 | $ 1,739 |
| Basic net income per share: | | |
| As reported | $ 0.04 | $ 0.12 |
| Pro forma | $ 0.03 | $ 0.11 |
| Diluted net income per share: | | |
| As reported | $ 0.04 | $ 0.11 |
| Pro forma | $ 0.03 | $ 0.10 |

The value of the options for the three and six months ended June 30, 2005 was estimated using a Black-Scholes option-pricing formula and amortized on a straight-line basis over the respective vesting periods of the awards, with forfeitures recognized as they occurred.

*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 recognize additional cost of sales may be required in future periods. Components of the reserve for warranty costs consisted of the following (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Beginning balance | 113 | 107 | 76 | 127 |
| Additions related to sales | 57 | 169 | 131 | 177 |
| Warranty costs incurred | (58) | (135) | (95) | (163) |
| Ending balance | 112 | 141 | 112 | 141 |

**2. Acquisition**

*Sieger Engineering, Inc.* On June 29, 2006, the Company completed the acquisition of Sieger, a privately-held company based in South San Francisco, California. The total purchase price was approximately $50.6 million, excluding acquisition costs of $1.2 million, and was comprised of cash consideration of $30.5 million and stock of $20.1 million. Sieger is a supplier of chemical mechanical planarization modules and other subsystems to the semiconductor and flat panel capital equipment industries. The Company anticipates that the acquisition may enhance its strategic position as a semiconductor equipment subsystem supplier. We have accounted for the acquisition of Sieger as a business combination and the operating results of Sieger have been included in our consolidated financial statements from the date of acquisition. We have not yet finalized the allocation of the purchase price to identifiable assets. Our preliminary allocation is as follows (in thousands):

| | |
|---|---|
| Tangible assets | $ 11,499 |
| Goodwill | 24,543 |
| Customer List | 13,800 |
| Trademark | 800 |
| Total | $ 50,642 |

*Pro Forma Results* The following pro forma financial information presents the combined results of operations of the Company and Sieger as if the acquisition had occurred as of the beginning of the periods presented. The unaudited pro forma financial information is not intended to represent or be indicative of the consolidated results of operations or financial condition of the Company that would have been reported had the acquisition been completed as of the dates presented, and should not be taken as representative of the future consolidated results of operations or financial condition of the Company.

| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Sales | $101,973 | $62,829 | $185,676 | $129,576 |

| | | | | |
|---|---|---|---|---|
| Net income | 6,217 | 1,238 | 9,862 | 3,568 |
| Basic net income per share | $ 0.30 | $ 0.07 | $ 0.49 | $ 0.19 |
| Diluted net income per share | $ 0.29 | $ 0.06 | $ 0.47 | $ 0.18 |

**3. Inventory**

Inventory consisted of the following (in thousands):

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| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Raw materials | $ 28,184 | $ 12,853 |
| Work in process | 13,909 | 5,796 |
| Finished goods | 3,012 | 457 |
| Total | $ 45,105 | $ 19,106 |

**4. Equipment and Leasehold Improvements, Net**

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

| | June 30, 2006 | December 31, 2005 |
|---|---|---|
| Computer equipment and software | $ 3,119 | $ 1,834 |
| Furniture and fixtures | 622 | 308 |
| Machinery and equipment | 22,991 | 2,960 |
| Leasehold improvements | 6,014 | 4,171 |
| Sub-total | 32,746 | 9,273 |
| Accumulated depreciation and amortization | (24,890) | (4,961) |
| Total | $ 7,856 | $ 4,312 |

**5. Notes Payable and Borrowing Arrangements**

*Bank Line of Credit* In connection with its acquisition of Sieger in the second quarter of 2006, the Company entered into a borrowing arrangement and an equipment loan. The loan and security agreement ( Loan Agreement ) provides senior secured credit facilities in an aggregate principal amount of up to $32.5 million, consisting of a $25 million revolving line of credit ($10 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. In addition, the term loan is subject to monthly amortization payments in 36 equal installments. Interest on outstanding loans under the revolving credit facility ranged from 7.75% to 8.0% as of June 30, 2006. The equipment loan is a 5-year, $5 million loan that is secured by certain of our equipment. Interest on the equipment loan was 7.3% as of June 30, 2006. As of June 30, 2006, the balances owing on the Loan Agreement and equipment loan were $27.5 million and $4.9 million, respectively.

During the first quarter of 2005, the Company entered into a loan and security agreement providing for a borrowing facility of up to $3.0 million with a bank in China. The borrowing facility is secured by a standby letter of credit issued under the Company s Loan Agreement. The interest rate on borrowings under the facility ranges from 6.0% to 6.1% per annum. As of June 30, 2006, the balance outstanding under the facility was $1,600,000, a portion of which was repayable in Renminbi.

In November 2004, the Company entered into a loan and security agreement. For the period ended June 30, 2006, no borrowings or repayments under the loan and security agreement were made and as of June 30, 2006, the agreement was terminated.

**6. Net Income Per Share**

Basic net income per share excludes dilution and is computed by dividing net income by the weighted average number of common shares outstanding for the period. Diluted net income 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 per share (in thousands):

| | **Three months ended June 30,** | | **Six months ended June 30,** | |
|---|---|---|---|---|
| | **2006** | **2005** | **2006** | **2005** |
| Numerator, basic and diluted net income | $ 3,957 | $ 692 | $ 6,088 | $ 1,886 |
| Denominator: | | | | |
| Shares used in computation basic: | | | | |
| Weighted average common shares outstanding | 18,335 | 16,398 | 17,656 | 16,384 |

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| | Three months ended June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Weighted average common shares outstanding subject to repurchase | (85) | (181) | (90) | (181) |
| Shares used in computing basic net income per share | 18,250 | 16,217 | 17,566 | 16,203 |
| Shares used in computation diluted: | | | | |
| Weighted average common shares outstanding | 18,250 | 16,217 | 17,566 | 16,203 |
| Dilutive effect of common shares outstanding subject to repurchase | 84 | 134 | 90 | 134 |
| Dilutive effect of options outstanding | 834 | 876 | 846 | 779 |
| Shares used in computing diluted net income per share | 19,168 | 17,227 | 18,502 | 17,116 |
| Net income per share basic | $ 0.22 | $ 0.04 | $ 0.35 | $ 0.12 |
| Net income per share diluted | $ 0.21 | $ 0.04 | $ 0.33 | $ 0.11 |

A total of 377,000 and 500,000 potentially dilutive securities have been excluded from the dilutive share calculation for the three months ended June 30, 2006 and 2005, respectively, as their effect was anti-dilutive. A total of 377,000 and 975,000 potentially dilutive securities have been excluded from the dilutive share calculation for the six months ended June 30, 2006 and 2005, respectively, as their effect was anti-dilutive.

**7. Related Party**

As part of the acquisition of Sieger, the Company leases a facility from an entity controlled by one of our executive officers. No rent expense was incurred for the three and six months ended June 30, 2006.

The wife of Bruce Weir, our Vice President of Engineering, is the sole owner of Acorn Travel, Inc., our primary travel agency. We incurred fees for travel-related services, including the cost of airplane tickets, of $83,000 and $140,000 for the three and six months ended June 30, 2006, respectively, and $55,000 and $119,000 for the three and six months ended June 30, 2005, respectively.

**8. Commitments and Contingencies**

At June 30, 2006, the Company had purchase commitments totaling $57,544,000 that related primarily to the purchase of inventory.

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 has infringed seven patents by developing and marketing products that use Celerity s fluid distribution technology. The Delaware litigation was transferred to the Northern District of California on October 19, 2005 and consolidated with our previously filed declaratory judgment action on December 12, 2005. The complaint by Celerity seeks injunction against future infringement of its patents and compensatory and treble damages. The Company believes that the claims made by Celerity are without merit and intends to defend the lawsuit vigorously.

**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, contin*

*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 relationship with our controlling shareholder, 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 Annual 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 industry. We develop, design, prototype, engineer, manufacture and test subsystems which are highly specialized and tailored to specific steps in the semiconductor manufacturing process. We derive the majority of our revenue from the sale of gas delivery systems and other

subsystems, including chemical delivery modules, top-plate assemblies, frame assemblies and process modules. Our primary customers are semiconductor equipment manufacturers.

We provide our customers complete subsystem solutions that combine our expertise in design, test, component characterization and highly flexible manufacturing operations with quality and financial stability. 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 subsystems, place us in a strong position to benefit from the growing demand for subsystem outsourcing.

A significant portion of our products consist of gas delivery systems that enable the precise delivery of numerous specialty gases used in a majority of the key steps in the semiconductor manufacturing process, including deposition, etch, diffusion, ion implantation, sputtering, photoresist stripping and annealing. Our products also include other subsystems, including chemical delivery modules, top-plate assemblies, frame assemblies and process modules. We began shipping frame assemblies in the second quarter of 2004, top-plate assemblies in the fourth quarter of 2004 and chemical delivery modules in the first quarter of 2005. We began manufacturing process modules for a semiconductor equipment manufacturer in our Menlo Park facility in the second quarter of 2005 and from our Shanghai facility in the third quarter of 2005.

Ultra Clean Holdings, Inc. was founded in November 2002 for the purpose of acquiring Ultra Clean Technology Systems and Services, 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, a California corporation. The total purchase price was approximately $50.6 million, net of acquisition costs of $1.2 million, and was comprised of cash consideration of $30.5 million and stock of $20.1 million. Sieger is a supplier of chemical mechanical planarization modules and other subsystems to the semiconductor and flat panel capital equipment industries. We anticipate that the acquisition may enhance our strategic position as a semiconductor equipment subsystem supplier. We conduct our operating activities primarily through our three wholly-owned subsidiaries, Ultra Clean Technology Systems and Service, Inc., Ultra Clean Technology (Shanghai) Co., LTD and UCT Sieger Engineering LLC.

*Financial Highlights*

Our operating results for the three and six months ended June 30, 2006 reflect a recovery in the semiconductor capital equipment industry. Sales for the second quarter of 2006 were $68.5 million, an increase of $11.3 million, or 19.7%, from the first quarter of 2006. Gross profit in the second quarter of 2006 also increased to $10.7 million, or 15.6% of sales, from $8.2 million, or 14.3% of sales, in the first quarter of 2006. Total operating expenses in the second quarter of 2006 increased to $5.5 million, or 8.0% of sales, from $4.4 million, or 7.8% of net sales, in the first quarter of 2006. Net income during the second quarter of 2006 increased to $4.0 million from $2.1 million in the first quarter of 2006 as a result of increased sales and gross margins experienced during the quarter, partially offset by higher operating expenses.

**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 June 30, | | Six months ended June 30, | |
|---|---|---|---|---|
| | 2006 | 2005 | 2006 | 2005 |
| Sales | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of goods sold | 84.4% | 85.8% | 85.0% | 84.9% |
| Gross Profit | 15.6% | 14.2% | 15.0% | 15.1% |

| | | | | |
|---|---|---|---|---|
| Operating expenses: | | | | |
| Research and development | 1.1% | 1.9% | 1.1% | 1.8% |
| Sales and marketing | 1.6% | 2.2% | 1.6% | 2.2% |
| General and administrative | 5.3% | 7.2% | 5.2% | 7.6% |
| Total operating expenses | 8.0% | 11.3% | 7.9% | 11.6% |
| Income from operations | 7.6% | 2.9% | 7.1% | 3.5% |
| Interest and other income (expense), net | (0.0%) | 0.1% | (0.4%) | 0.1% |
| Income before income taxes | 7.6% | 3.0% | 6.7% | 3.6% |
| Income tax provision | 1.8% | 1.2% | 1.9% | 1.2% |
| Net income | 5.8% | 1.8% | 4.8% | 2.4% |

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*Sales*

Sales in the second quarter of 2006 increased 74.3% to a record high $68.5 million from $39.3 million in the second quarter of 2005. The increase reflects a rebound in demand that began during the first quarter of 2006. Sales in the second quarter of 2006 of non-gas panel assemblies increased to $10.7 million from $2.4 million in the second quarter of 2005, reflecting continued market penetration outside our traditional gas-panel business. Sales for the six months ended June 30, 2006 increased 54.7% to $125.7 million from $81.2 million in the six months ended June 30, 2005, reflecting continued strong market demand for semiconductor equipment. We expect a significant increase in sequential revenues for the remainder or the year as we consolidate results for our newly-acquired UCT Sieger subsidiary and continue to increase production levels at our China subsidiary.

Historically, a relatively small number of OEM customers have accounted for a significant portion of our sales. In the three and six months ended June 30, 2006 and 2005, respectively, 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 91% and 90% of the Company s sales for the three and six months ended June 30, 2006 and 2005, respectively.

*Gross Profit*

Cost of goods sold consists primarily of purchased materials, labor and overhead, including depreciation associated with the design and manufacture of products sold. Gross profit for the second quarter of 2006 increased to $10.7 million, or 15.6% of net sales, from $5.6 million, or 14.2% of net sales, in the second quarter of 2005. Gross profit for the six months ended June 30, 2006 increased $6.7 million to $18.9 million, or 15.0% of net sales, from $12.2 million, or 15.1% of net sales, in the six months ended June 30, 2005. The increase in gross profit in dollars is due primarily to a higher sales volume. We expect gross margins to decline slightly from the second quarter of 2006 as we consolidated results from UCT Sieger.

*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 2006 was $0.7 million, or 1.1% of net sales, compared with $0.7 million, or 1.9% of net sales, for the second quarter of 2005. Research and development expense for the six months ended June 30, 2006 was $1.3 million, or 1.1% of net sales, compared with $1.4 million, or 1.8% of net sales, in the six months ended June 30, 2006. We expect research and development expenses to remain relatively flat during fiscal year 2006.

*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 2006 was $1.1 million, or 1.6% of net sales, compared with $0.9 million, or 2.2% of net sales, in the second quarter of 2005. Sales and marketing expense for the six months ended June 30, 2006 increased $0.3 million to $2.1 million, or 1.6% of net sales, from $1.8 million, or 2.2% of net sales, in the six months ended June 30, 2005. The increase in dollars was due primarily to an increase in headcount from 17 in the second quarter of 2005 to 21 in the second quarter of 2006.

*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 for the second quarter of 2006 was $3.6 million, or 5.3% of net sales, compared with $2.9 million, or 7.2% of net sales, in the second quarter of 2005. General and administrative expense for the six months ended June 30, 2006 increased $0.3 million to $6.5 million, or 5.2% of sales, from $6.2 million, or 7.6% of net sales, in the six months ended June 30, 2005. The increase is due primarily to an increase in headcount from 39 in June 2005 to 46 in June 2006 and higher levels of accounting and consulting costs in connection with Sarbanes-Oxley 404 compliance requirements.

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*Interest and Other Income (Expense), net*

Interest and other income (expense), net for the second quarter of 2006 was comparable to the second quarter of 2005. The increase in interest and other income (expense), net for the six months ended June 30, 2006 over the comparable prior period is due to $0.5 million in charges related to legal, accounting and other registration fees associated with the secondary component of our equity offering which closed in March 2006.

*Income Tax Provision*

Our effective tax rates for the second quarter of 2006 and 2005 were 23.6% and 39.6%, respectively. Our effective tax rates for the six months ended June 30, 2006 and 2005 were 27.9% and 34.5%, respectively. The decreased rate in 2006 reflects primarily a change in the geographic mix of worldwide earnings and financial results for fiscal year 2006 compared with fiscal year 2005 as a higher portion of our income is being generated from our Shanghai subsidiary.

**Liquidity and Capital Resources**

As of June 30, 2006, we had cash of $19.0 million compared to $10.7 million as of December 31, 2005.

Net cash used in operating activities for the six months ended June 30, 2006 increased to $5.7 million from $2.1 million in the comparable period of fiscal 2005. The increase is due primarily to higher working capital needs required to support higher levels of sales activity. We used $12.0 million of cash for inventory purchases and $18.8 million to support accounts receivable. These amounts were partially offset by higher levels of payables of $16.5 million in accounts payable and $2.5 million in accrued compensation and related benefits.

Net cash used in investing activities for the six months ended June 30, 2006 increased to $28.6 million from $0.6 million in the comparable period of fiscal 2005. The increase was due primarily to our acquisition of Sieger and higher levels of equipment purchases relating to cleanroom expansion activities.

Net cash provided by financing activities for the six months ended June 30, 2006 increased to $42.6 million from $2.5 million in the comparable period of fiscal 2005. The increase was due primarily to bank borrowings and stock issued in connection with our acquisition of Sieger.

In connection with our acquisition of Sieger in the second quarter of 2006, we entered into a borrowing arrangement and an equipment loan. The loan and security agreement ( Loan Agreement ) provides senior secured credit facilities in an aggregate principal amount of up to $32.5 million, consisting of a $25 million revolving line of credit ($10 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 our assets. Each of the credit facilities will expire on June 29, 2009 and contain certain financial covenants, including minimum profitability and liquidity ratios. In addition, the term loan is subject to monthly amortization payments in 36 equal installments. Interest on outstanding loans under the revolving credit facility ranged from 7.75% to 8.0% as of June 30, 2006. The equipment loan is a 5-year, $5 million loan that is secured by certain of our equipment. Interest on the equipment loan was 7.3% as of June 30, 2006. As of June 30, 2006, the balances owing on the Loan Agreement and equipment loan were $27.5 million and $4.9 million, respectively.

During the first quarter of 2005, we entered into a loan and security agreement providing for a borrowing facility of up to $3.0 million with a bank in China. The borrowing facility is secured by a standby letter of credit issued under our Loan Agreement. The interest rate on borrowings under the facility ranges from 6.0% to 6.1% per annum. As of June 30, 2006, the balance outstanding under the facility was $1,600,000, a portion of which was repayable in Renminbi.

We anticipate that we will continue to finance our operations with cash flows from operations, existing cash balances and a combination of long-term debt and/or lease financing and additional sales of equity securities. The combination and sources of capital will be determined by management based on our then-current needs and prevailing market conditions.

Although cash requirements fluctuate based on the timing and extent of many factors, management believes that cash generated from operations, together with the liquidity provided by existing cash balances and borrowing capability, will be sufficient to satisfy our liquidity requirements for at least the next 12 months.

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**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 presents a summary of our future minimum lease payments:

| | Year ending December 31, | | | | | | |
|---|---|---|---|---|---|---|---|
| **Year ending December 31,** | **Remainder of 2006** | **2007** | **2008** | **2009** | **2010** | **2011** | **Total** |
| Purchase obligations | $ 57,544 | | | | | | $ 57,544 |
| Capital lease obligations | 34 | 55 | 24 | 4 | | | 117 |
| Operating lease obligations* | 1,181 | 2,010 | 1,273 | 782 | 39 | | 5,285 |
| Borrowing arrangements | 2,881 | 3,397 | 3,465 | 23,888 | 1,116 | 490 | 35,237 |
| Total | $ 61,640 | $ 5,462 | $ 4,762 | $ 24,674 | $ 1,155 | $ 490 | $ 98,183 |

* Operating lease expense reflects the fact that (1) the lease for our headquarters facility in Menlo Park, California expires on December 31, 2007 and may not be terminated by our landlord upon less than nine months prior written notice; (2) the lease for our manufacturing facility in Portland, Oregon expires on November 7, 2007 and (3) one of the leases for our manufacturing facility in South San Francisco, California expires on May 31, 2007.

We expect to renew our Menlo Park, Portland and South San Francisco leases prior to expiration or lease other facilities. Operating lease expense set forth above will increase upon renewal of these leases.

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

In June 2006, the Financial Accounting Standards Board ( FASB ) issued 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 the Company recognize in the 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 provisions of FIN 48 will be effective as of the beginning of the Company s 2007 fiscal year, with the cumulative effect of the change in accounting principle recorded as an adjustment to opening retained earnings. The Company is currently evaluating the impact of adopting FIN 48 on the consolidated financial statements.

On January 1, 2006 the Company implemented the provisions of Statement of Financial Accounting Standards No. 123(R), Share-Based Payments ( SFAS 123(R) ), using the modified prospective transition method. SFAS 123(R) requires companies to recognize the cost of employee services received in exchange for awards of equity instruments based upon the grant-date fair value of those awards. Using the modified prospective transition method of adopting SFAS 123(R), the Company began recognizing compensation expense for equity-based awards granted after January 1, 2006 plus unvested awards granted prior to January 1, 2006. Under this method of implementation, no restatement of prior periods has been made.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs ( SFAS 151 ), an amendment of Accounting Research Bulletin No. 43, Chapter 4. SFAS 151 clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material. We adopted the provisions of SFAS 151 on January 1, 2006 and the adoption did not have a material effect on our consolidated results of operations or financial position.

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, 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 Sieger acquisition, 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. A further discussion can be found in Management s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K filed with the SEC on February 28, 2006.

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**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. During the first quarter of fiscal 2005, we entered into a loan and security agreement providing for revolver loans of up to $3.0 million with a bank in China. One of the two revolver loans outstanding as of June 30, 2006 is denominated in Chinese Yuan and is secured by a standby letter of credit issued under our Loan Agreement described above. Interest on the two revolver loans ranges between 6.0% and 6.1% per annum. Interest is payable quarterly and principal is payable within 12 months of borrowing. As of June 30, 2006, the balance outstanding under the two revolver loans was $1.6 million. If we enter into future borrowing arrangements or borrow under our existing revolving credit facility, we may seek to manage our exposure to interest rate changes by using a mix of debt maturities and variable- and fixed-rate debt, together with interest rate swaps where appropriate, to fix or lower our borrowing costs. 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 $7.1 million in United States Dollar equivalents. We have performed a sensitivity analysis assuming a hypothetical 10-percent movement in foreign currency exchange rates and interest rates applied to the underlying exposures described above. As of June 30, 2006, 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.

**Item 4.** ***Controls and Procedures***

As of the end of the period covered by this report on Form 10-Q, our Chief Executive Officer and Chief Financial Officer evaluated, with the participation of our management, the effectiveness of our disclosure controls and procedures. Based on the evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures were effective at the reasonable assurance level and designed to ensure that material information related to us and our consolidated subsidiaries would be made known to them by others within these entities.

There has been no change in our internal controls over financial reporting during the most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

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## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

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 has infringed seven patents by developing and marketing products that use Celerity s fluid distribution technology. The Delaware litigation was transferred to the Northern District of California on October 19, 2005 and consolidated with our previously filed declaratory judgment action on December 12, 2005. The complaint by Celerity seeks injunction against future infringement of its patents and compensatory and treble damages. The Company believes that claims made by Celerity are without merit and intends to defend the lawsuit vigorously.

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

### Item 1A. Risk Factors

A restated description of the risk factors associated with our business is set forth below. This description includes any material changes to and supersedes the description of the risk factors associated with our business previously disclosed in Part I, Item 1A of our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

***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 $147.5 million in 2005, $184.2 million in 2004 and $77.5 million in 2003. 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 caused companies to reduce capital investment and may cause further reduction of such investments. These reductions have been particularly severe in the semiconductor capital equipment industry. A potential rebound in the worldwide economy in the near future will not necessarily mean that our business will experience similar effects.

***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 has historically accounted for a significant portion of our sales, and we expect this trend to continue. Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc. as a group accounted for 89% of our sales in 2005, 93% of our sales in 2004 and 92% of our sales in 2003. Because of the small number of OEMs in our industry, most of whom 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 a small number of customers.

In addition, by virtue of our customers size and the significant portion of our 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.

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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 have significant existing debts; 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 a significant amount of outstanding indebtedness. At June 30, 2006, our long-term debt was $28.6 million and our short-term debt was $6.2 million, for an aggregate total of $34.8 million. Our $32.5 million loan agreement requires compliance with certain financial covenants, including a leverage and fixed charge coverage target and a requirement that we maintain $5.0 million of cash and cash equivalents with the bank during the term. 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 shareholders and affiliates;
- create liens;
- sell or otherwise dispose of assets;
- make payments on our debt, other than in the ordinary course; and
- engage in 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 quarters. If we are unable to meet any covenants, we cannot assure you the bank will grant waivers and amend the covenants, or that the bank will not terminate the agreement, preclude further borrowings or require us to repay any outstanding borrowings. As long as our indebtedness remains outstanding, the restrictive covenants could impair our ability to expand or pursue our business strategies or obtain additional funding. Forced prepayment of some or all of our indebtedness would reduce our available cash balances and have an adverse impact on our operating and financial performance.

***We may not be able to integrate efficiently the operations of our acquisition of newly acquired subsidiaries.***

We have made, and may continue to make, additional acquisitions of, or significant investments in, businesses that offer complementary products, services, technologies or market access. If we are to realize the anticipated benefits of past and any 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, will continue to 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 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.

***We have identified significant deficiencies in the internal controls of Sieger that existed prior to our acquisition of Sieger and the identification of any significant deficiencies in the future could affect our ability to ensure timely and reliable financial reports.***

We have identified significant deficiencies in the internal controls of Sieger that existed prior to our acquisition of Sieger. The Public Company Accounting Oversight Board ( PCAOB ) defines a significant deficiency as a control deficiency, or a combination of control deficiencies, that adversely affects the company s ability to initiate, authorize, record, process, or report external financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the company s annual or interim financial statements that is more than inconsequential will not be prevented or detected. We are in the process of implementing changes to strengthen the internal controls of UCT Sieger. However, additional measures may be necessary and these measures, along with other measures we expect to take to improve the internal controls of UCT Sieger, may not be sufficient to address the issues identified by us or ensure that the internal controls of UCT Sieger are effective.

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 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.

***We have established operations in China, which exposes us to new risks associated with operating in a foreign country.***

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; and
- potentially adverse tax consequences.

In addition, while 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 a 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;
- 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 new manufacturing facility 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 received a claim of infringement from Celerity, Inc. that is currently pending and we may receive notices of other such claims in the future. 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. See Item 1 Legal proceedings.

***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 customer specifications, we would 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 gas delivery systems and other subsystems, which would adversely impact our operating results.***

The success of our business depends on OEMs continuing to outsource the manufacturing of gas delivery systems and other subsystems for their semiconductor capital equipment. Most of the largest OEMs have already outsourced production of a significant portion of their gas delivery systems and other subsystems. If OEMs do not continue to outsource gas delivery systems and other 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 gas delivery systems and other 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 gas delivery systems and other subsystems to OEMs. Sales of these 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, to coordinate our technical personnel and strategic relationships and to 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. Gross margins on 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, 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. Due to the cyclical nature of the semiconductor industry, however, 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.

***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 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.

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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 gas delivery systems 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 gas delivery systems or other 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.

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***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;
- 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.

***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, Vice President of Engineering, Vice President of Sales and Vice President of Technology, 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 made capital expenditures of $1.1 million in 2005, most of which was for facility leasehold improvements and equipment in connection with the establishment of a manufacturing facility in Shanghai, China, and we made capital expenditures of $3.3 million in 2004 and $0.2 million in 2003. 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 matures 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 Shanghai subsidiary are paid in Chinese Renminbi, and we expect our exposure to Chinese Renminbi to increase as we ramp up production in that facility. In addition, purchases of some of our components are denominated in Japanese Yen. Changes in exchange rates among other currencies in which our revenue or costs are denominated and the U.S. dollar may affect our revenue, cost of sales and operating margins. While fluctuations in the value of our revenue, cost of sales and operating margins as measured in U.S. dollars have not materially affected our results of operations historically, we do not currently hedge our exchange exposure, and

exchange rate fluctuations could have an adverse effect on our financial condition and results of operations in the future.

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

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

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

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

***We may not be able to continue to secure adequate facilities to house our operations, and any move to a new facility could be disruptive to our operations.***

On January 19, 2006, we extended the lease for our Menlo Park headquarters and manufacturing facility through December 31, 2007. If we are unable to renew our lease on favorable terms after this date we will be forced to relocate all manufacturing, engineering, sales and marketing and administrative functions currently housed in Menlo Park to new facilities. This move could disrupt our operations and we would incur additional costs associated with relocation to new facilities, which could have a material adverse effect on our results of operations.

***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. We have been classified as an Accelerated Filer, as defined in Exchange Act Rule 12-b-2 as of the end of the second quarter of Fiscal 2006. As a result, our auditors will likely be required to audit and report on the effectiveness of our internal controls over financial reporting beginning with our Annual Report on Form 10-K for the year ending December 31, 2006. 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. We will also experience additional costs, especially in 2006, as we complete documentation of our internal control procedures in anticipation of our Section 404 compliance.

**Risks related to the securities markets and ownership of our common stock**

***Future sales of our common stock by our significant stockholders could depress our stock price.***

Sales of substantial amounts of our common stock by FP-Ultra Clean, L.L.C., or the perception that these sales might occur, may depress prevailing market prices of our common stock. The shares owned by FP-Ultra Clean, L.L.C. and by the former stockholders of Sieger are governed by an agreement with us that provides them certain demand and piggyback registration rights.

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***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.

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**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**

None

**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 30, 2006:

| 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 Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

## 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) |
| August 14, 2006 | By: | /s/ Clarence L. Granger |
| | Name: | Clarence L. Granger |
| | Title: | Chief Executive Officer (Principal Executive Officer) |
| August 14, 2006 | By: | /s/ Jack Sexton |
| | Name: | Jack Sexton |
| | Title | Chief Financial Officer (Principal Financial Officer) |

Exhibit Index

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