ULTRA CLEAN HOLDINGS INC
Form 10-K
February 28, 2006

Table of Contents

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

(Mark one)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended December 31, 2005

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)	*(IRS Employer Identification No.)*
150 Independence Drive **Menlo Park, California** *(Address of principal executive offices)*	**94025-1136** *(Zip Code)*

Registrant s telephone number, including area code:
(650) 323-4100

Securities registered pursuant to Section 12(b) of the Act:
None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, $0.001 par value

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer (as defined in Rule 12b-2 of the 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 by Rule 12b-2 of the Act). Yes o No þ

The aggregate market value of the voting and non-voting stock held by non-affiliates of the Registrant, based on the closing sale price of the Registrant s common stock on June 30, 2005, as reported on the Nasdaq National Market, was approximately $54.7 million. Shares of common stock held by each executive officer and director and by each person who may be deemed to be an affiliate of the Registrant have been excluded from this computation. The determination of affiliate status for this purpose is not necessarily a conclusive determination for other purposes.

Number of shares of the registrant s common stock outstanding as of February 20, 2006: 16,585,900

TABLE OF CONTENTS

Table of Contents

PART I

This Annual Report on Form 10-K 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, continues, may, variations of such words, a 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.

ITEM 1. *Business*

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. Currently, our revenue is derived primarily from the sale of gas delivery systems. We are increasing our revenue related to the sale of 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 control 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, place us in a strong position to benefit from the growing demand for subsystem outsourcing.

We had sales of $147.5 million, $184.2 million and $77.5 million for the years ended December 31, 2005, 2004 and 2003, respectively. Our three largest customers in 2005 were Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc.

To date, we ship substantially all of our products to customers in the United States. Our international sales represented 6%, 3% and 4% of net sales for the years ended 2005, 2004 and 2003, respectively.

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. We conduct our

operating activities primarily through our two wholly-owned subsidiaries, Ultra Clean Technology Systems and Service, Inc. and Ultra Clean Technology (Shanghai) Co., LTD.

Our Solution

We are a leading developer and supplier of critical subsystems for the semiconductor capital equipment industry. Our products enable our original equipment manufacturer, or OEM, customers to realize lower manufacturing costs and reduced design-to-delivery cycle times while maintaining quality.

Table of Contents

We offer our customers:

An integrated outsourced solution for gas delivery systems and other subsystems. We provide our OEM customers a complete outsourced solution for the development, design, prototyping, engineering, manufacturing and testing of advanced gas delivery systems. We also provide outsourced solutions for chemical delivery modules, top-plate assemblies, frame assemblies and process modules. We combine highly specialized engineering and manufacturing capabilities to produce high performance products that are customized to meet the needs of our customers, as well as their respective end users. We manage supply chain logistics in an effort to reduce the overall number of suppliers and inventory levels that our customers would otherwise be required to manage. We also believe we are often in a position to negotiate reduced component prices due to our large volume orders.

Improved design-to-delivery cycle times. Our strong relationships with our customers and intimate familiarity with their products and requirements help us reduce design-to-delivery cycle times for gas delivery systems and other subsystems. We have optimized our supply chain management, design and manufacturing coordination and controls to respond rapidly to order requests, enabling us to decrease design-to-delivery cycle times for our customers.

Component neutral design and manufacturing. We do not manufacture any of the components within our gas delivery systems and other subsystems ourselves. Our component neutral position enables us to recommend components on the basis of technology, performance and cost and to optimize our customers overall designs based on these criteria. Furthermore, our neutral approach allows us to maintain close relationships with a wide range of component suppliers.

Component testing capabilities. We utilize our engineering expertise to test and characterize key components and subsystems. We have made significant investments in advanced analytical and automated test equipment to test and qualify key components. We can perform diagnostic tests, design verification and failure analysis for customers and suppliers. Our analytical and testing capabilities enable us to evaluate multiple supplier component technologies and provide customers with a wide range of appropriate component and design choices for their subsystems.

Increased integration with OEMs through local presence. Our local presence in close proximity to the facilities of most of our OEM customers enables us to remain closely integrated with their design, development and implementation teams. This level of integration enables us to respond quickly and efficiently to customer changes and requests.

Our Strategy

Our objective is to maintain our position as a leading developer and supplier of gas delivery systems and become a leading developer and supplier of other critical subsystems, primarily for the semiconductor capital equipment industry.

Our strategy is comprised of the following key elements:

Continue to expand our market share with OEMs. We believe that the increase in outsourcing among OEMs creates a significant market opportunity for us to grow our business with existing and new customers. We believe that our continued focus on efficient manufacturing, reduced design-to-delivery cycle times and quality and reliability will also allow us to gain market share.

Leverage our expanding geographic presence in lower cost manufacturing regions. In March 2005, we completed construction of a manufacturing facility in Shanghai, China, allowing us to expand production in a low cost region. This facility puts us in close proximity to the manufacturing facilities of potential customers and their end users.

Drive profitable growth with our flexible cost structure. We implement cost containment and capacity enhancement initiatives throughout the semiconductor capital equipment demand cycle and benefit greatly from our supply chain efficiencies. In addition, we believe our Shanghai facility positions us to respond effectively to future business demands.

Table of Contents

Selectively pursue strategic acquisitions. We may choose to accelerate the growth of our business by selectively pursuing strategic acquisitions. We have in the past considered and will continue to consider acquisitions that will enable us to expand our geographic presence, secure new customers and diversify into complementary products and markets as well as broaden our technological capabilities in semiconductor capital equipment manufacturing.

Products

We develop, design, prototype, engineer, manufacture and test subsystems, primarily for the semiconductor capital equipment industry. A substantial majority 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, chemical mechanical planarization (a process used to polish off high spots on wafers or films deposited on wafers), cleaning and annealing. Our gas delivery systems control the flow, pressure, sequencing and mixing of specialty gases into and out of the reaction chambers of semiconductor manufacturing tools. Our products also include other subsystems, including chemical delivery modules, top-plate assemblies, frame assemblies and process modules.

Gas delivery systems. A typical gas delivery system consists of one or more gas lines, comprised of several filters, mass flow controllers, regulators, pressure transducers and valves, associated interconnect tubing and an integrated electronic and/or pneumatic control system. These systems are mounted on a pallet and are typically enclosed in a sheet metal encasing. Our gas delivery system designs are developed in collaboration with our customers and are customized to meet the needs of specific OEMs. We do not sell standard systems. Our customers either specify the particular brands of components they want incorporated into a particular system or rely on our design expertise and component characterization capabilities to help them select the appropriate components for their particular system.

Chemical delivery modules. Chemical delivery modules deliver gases and reactive chemicals from a centralized subsystem to the reaction chamber and may include gas delivery systems, as well as liquid and vapor delivery systems.

Top-plate assemblies. Top-plate assemblies form the top portion of the reaction chamber within which gases controlled by our gas delivery systems react to form thin films or etch films on the wafer.

Frame assemblies. Frame assemblies are steel tubing that form the support structure to which all other assemblies are attached and include pneumatic harnesses and cables that connect other subsystems together.

Process modules. Process modules refer to the larger subsystems of semiconductor manufacturing tools that process integrated circuits onto wafers. Process modules include several smaller subsystems such as the frame assembly, top-plate assembly and gas and chemical delivery modules, as well as the chamber and electronic, pneumatic and mechanical subsystems.

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. We shipped a total of 30 process modules in 2005 from our Menlo Park and Shanghai facilities. In addition, we began shipping a catalytic steam generator (CSGS) in the first quarter of 2004.

Customers

We sell our products to semiconductor capital equipment manufacturers. This industry is highly concentrated and we are therefore highly dependent upon a small number of customers. Our three largest customers in 2005 were Applied Materials, Inc., Lam Research Corporation and Novellus Systems, Inc. and each accounted for more than 10% of our total sales in 2005. As a percentage of total revenue, sales to our three largest customers were 89%, 93% and 92% for the years ended December 31, 2005, 2004 and 2003, respectively.

Table of Contents

We have successfully qualified as a supplier with each of our customers. This lengthy qualification process involves the inspection and audit of our facilities and evaluation by our customers of our engineering, documentation, manufacturing and quality control processes and procedures before that customer places orders for our products. Our customers generally place orders with suppliers who have met and continue to meet their qualification criteria.

Sales and Support

We sell our products through our direct sales force which, as of December 31, 2005, consisted of a total of 17 sales directors, account managers and sales support staff. Our sales directors are responsible for establishing sales strategy and setting the objectives for specific customer accounts. Each account manager is dedicated to a specific customer account and is responsible for the day-to-day management of that customer. Account managers work closely with customers and in many cases provide on-site support. Account managers often attend customers internal meetings related to production, engineering design and quality to ensure that customer expectations are interpreted and communicated properly to our operations group. Account managers also work with our customers to identify and meet their cost and design-to-delivery cycle time objectives.

We have dedicated account managers responsible for new business development for gas delivery systems and other subsystems. Our new business development account managers initiate and develop long-term, multi-level relationships with customers and work closely with customers on new business opportunities throughout the design-to-delivery cycle.

Our sales force includes technical sales support for order placement, spare parts quotes and production status updates. We have a technical sales representative located at each of our manufacturing facilities. In addition, we have developed a service and support infrastructure to provide our customers with service and support 24 hours a day, seven days a week. Our dedicated field service engineers provide customer support through the performance of on-site installation, servicing and repair of our subsystems.

Technology Development

We engage in ongoing technology development efforts in order to remain a technology leader for gas delivery systems and to develop other subsystems. We have a technology development group which, as of December 31, 2005, consisted of three individuals, two of whom hold doctoral degrees. In addition, our design engineering and new product engineering groups support our technology development activities.

Our technology development group works closely with our customers to identify and anticipate changes and trends in next-generation semiconductor manufacturing equipment. Our technology development group participates in customer technology partnership programs that focus on process application requirements for gas delivery systems and other subsystems. These development efforts are designed to meet specific customer requirements in the areas of subsystem design, materials, component selection and functionality. Our technology development group also works directly with our suppliers to help them identify new component technologies and make necessary changes in, and enhancements to, the components that we integrate into our products. Our analytical and testing capabilities enable us to evaluate multiple supplier component technologies and provide customers with a wide range of appropriate component and design choices for their gas delivery systems and other subsystems. Our analytical and testing capabilities also help us anticipate technological changes and the requirements in component features for next-generation gas delivery systems and other subsystems. We are also developing additional features to improve the performance and functionality of our gas delivery systems and other subsystems.

Our self-funded technology development and new product engineering expenses were approximately $2.4 million, $2.4 million and $1.2 million for 2005, 2004 and 2003, respectively. We perform our technology development

activities principally at our facilities in Menlo Park, California.

Intellectual Property

Our success depends in part on our ability to maintain and protect our proprietary technology and to conduct our business without infringing the proprietary rights of others. Our business is largely dependent upon our design,

Table of Contents

engineering, manufacturing and testing know-how. We also rely on a combination of trade secrets and confidentiality provisions, and to a much lesser extent, patents, copyrights and trademarks, to protect our proprietary rights. As of December 31, 2005, we had four issued United States patents, all of which expire in 2018, and we had six United States patent applications pending. None of our issued patents is material to our business. Intellectual property that we develop on behalf of our customers is generally owned exclusively by those customers.

We routinely require our employees, suppliers and potential business partners to enter into confidentiality and non-disclosure agreements before we disclose to them any sensitive or proprietary information regarding our products, technology or business plans. We require employees to assign to us proprietary information, inventions and other intellectual property they create, modify or improve.

Competition

Our industry is highly fragmented. When we compete for new business, we face competition from other suppliers of gas delivery systems and other subsystems as well as an OEM s internal manufacturing group. In addition, OEMs that have elected to outsource their gas delivery systems and other subsystems could elect in the future to develop and manufacture these subsystems internally, leading to further competition. Our principal competitors for our gas delivery systems are Celerity Group, Inc., Integrated Flow Systems, LLC, Matheson Tri-Gas, Inc. and Wolfe Engineering, Inc., and our principal competitors for other subsystems are Allegro MicroSystems, Inc., Flextronics International Ltd., Fox Semicon Integrated Tech Inc. and Sanmina-SCI Corporation. Some of these competitors have substantially greater financial, technical, manufacturing and marketing resources than we do. We expect our competitors to continue to improve the performance of their current products and to introduce new products or new technologies that could adversely affect sales of our current and future products. In addition, the limited number of potential customers in our industry further intensifies competition.

The primary competitive factors in our industry are price, technology, quality, design-to-delivery cycle time, reliability in meeting product demand, service and historical customer relationships. We anticipate that increased competitive pressures will cause intensified price-based competition and we may have to reduce the prices of our products. In addition, we expect to face new competitors as we enter new markets.

Employees

As of December 31, 2005, we employed 378 employees, of which 72 were temporary. Of our total employees, there were 52 in engineering, three in technology development, 17 in sales and support, 160 in direct manufacturing, 104 in indirect manufacturing and 42 in executive and administrative functions. These figures include 60 employees in Shanghai, China. None of our employees is represented by a labor union and we have not experienced any work stoppages.

Governmental Regulation and Environmental Matters

Our operations are subject to federal, state and local regulatory requirements and foreign laws relating to environmental, waste management and health and safety matters, including measures relating to the release, use, storage, treatment, transportation, discharge, disposal and remediation of contaminants, hazardous substances and wastes, as well as practices and procedures applicable to the construction and operation of our facilities. Our past or future operations may result in exposure to injury or claims of injury by employees or the public which may result in material costs and liabilities to us. Although some risk of costs and liabilities related to these matters is inherent in our business, we believe that our business is operated in substantial compliance with applicable regulations. However, new, modified or more stringent requirements or enforcement policies could be adopted, which could adversely affect us.

Available Information

We file with the SEC annual reports on Form 10-K, quarterly reports on Form 10-Q and current reports on Form 8-K pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended, or the Exchange Act. You may read and copy any materials we file with the SEC at the public reference facilities maintained by the SEC at Room 1024, Judiciary Plaza, 100 F Street, N.E., Washington, D.C. 20549. You may also request copies of all

Table of Contents

or any portion of such material from the SEC at prescribed rates. Please call the SEC at 1-800-SEC-0330 for further information on the operation of the public reference room. In addition, materials filed electronically with the SEC are available at the SEC s website at http://www.sec.gov.

In addition, we make available free of charge, on or through our website at http://www.uct.com, our annual, quarterly and current reports and any amendments to those reports, as soon as reasonably practicable after electronic filing such reports with, or furnishing them to, the SEC. This website address is intended to be an inactive textual reference only; none of the information contained on our website is part of this report or is incorporated by reference herein.

ITEM 1A. ***Risk Factors***

Risks related to our business

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. Beginning in the third quarter of 2004, we started to experience a weakening in new orders and an increase in customer requests for cancellations and postponements of existing orders that continued through the third quarter of 2005. 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 a substantial portion of their 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.

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

Table of Contents

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 recently 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 operations in China, 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;

Table of Contents

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 the attention of 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 3 Legal Proceedings.

Because we are subject to order and shipment uncertainties, 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

Table of Contents

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

Table of Contents

management and experienced personnel. If we do not manage growth properly, our business, operating results and financial condition could be adversely affected.

We may experience difficulties and incur significant costs as a result of evaluating or completing acquisitions of companies, assets, businesses or technologies, and the anticipated benefits of any completed or contemplated acquisitions may never be realized.

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 costs 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. Any future acquisitions would be accompanied by risks such as:

- difficulties in assimilating the operations and personnel of acquired companies or businesses;
- difficulties in integrating information systems of acquired companies or businesses;
- diversion of management s attention from ongoing business concerns;
- inability to maximize our financial and strategic position through the successful incorporation of acquired technology into our products;
- additional expense associated with amortization or depreciation of acquired assets;
- maintenance of uniform standards, controls, procedures and policies;
- impairment of existing relationships with employees, suppliers and customers as a result of the integration of new personnel;
- dilution to our stockholders in the event we issue stock as consideration to finance an acquisition; and
- increased leverage if we incur debt to finance an acquisition.

We may not be successful in integrating any business, products, technologies or personnel that we acquire, and our failure to do so could have a material adverse effect on our business, operating results and financial condition.

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

Table of Contents

designs, develop the technical capabilities necessary to manufacture new products or make necessary modifications or enhancements to existing products, our business prospects could be harmed.

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

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

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

Our competitors are primarily companies that design and manufacture 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.

Table of Contents

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

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

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

mobilize our supply chain in order to maintain component and raw material supply;

optimize the use of our design, engineering and manufacturing capacity in a timely manner;

deliver our products to our customers in a timely fashion;

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;

Table of Contents

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 our Shanghai facility, 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 credit facility matures on June 30, 2006 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.

Table of Contents

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 facility are paid in Chinese Renminbi, and we expect our exposure to the 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 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 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, California, 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 anticipate being classified as an accelerated filer, as defined in Rule 12b-2 of the Exchange Act as of the end of the second quarter of fiscal 2006. As a result, our auditors will be required to audit and report on the effectiveness of our internal controls over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act, 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

Table of Contents

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 our ownership by Francisco Partners

We will continue to be controlled by FP-Ultra Clean, L.L.C. as long as FP-Ultra Clean, L.L.C. owns a significant percentage of our common stock, and therefore our other stockholders will be unable to affect the outcome of stockholder voting during such time.

FP-Ultra Clean, L.L.C., an entity controlled by Francisco Partners, L.P., owns approximately 55% of our outstanding common stock. Pursuant to a stockholders agreement, FP-Ultra Clean, L.L.C. has the right to nominate for election a majority of the members of our board of directors for so long as it holds at least 25% of our outstanding common stock.

The stockholders agreement also provides that our board of directors may not take certain significant actions without the approval of FP-Ultra Clean, L.L.C. as long as FP-Ultra Clean, L.L.C. owns at least 25% of our outstanding common stock. These actions include:

- mergers, acquisitions or certain sales of assets;
- any liquidation, dissolution or bankruptcy;
- issuances of securities;
- determination of compensation and benefits for our chief executive officer and chief financial officer;
- appointment or dismissal of any of the chairman of our board of directors, chief executive officer, chief financial officer or any other executive officer in any similar capacity;
- amendments to the stockholders agreement or exercise or waiver of rights under the stockholders agreement;
- amendments to our charter or bylaws;
- any increase or decrease in the number of directors that comprise our board of directors;
- the declaration of dividends or other distributions;
- any incurrence or refinancing of indebtedness in excess of $10 million;
- approval of our business plan, budget and strategy; and
- modification of our long-term business strategy.

Such power could have the effect of delaying, deterring or preventing a change of control, business combination or other transaction that might otherwise be beneficial to our stockholders. FP-Ultra Clean, L.L.C. also is not prohibited from selling a controlling interest in us to a third party or a participant in our industry.

FP-Ultra Clean, L.L.C. and its designees on our board of directors may have interests that conflict with our interests and the interests of our other stockholders.

FP-Ultra Clean, L.L.C. and its designees on our board of directors may have interests that conflict with, or are different from, our own and those of our other stockholders. Francisco Partners, L.P., which controls FP-Ultra Clean, L.L.C., has invested in, or acquired other businesses that are involved in, the semiconductor industry and may invest in or acquire others in the future. Conflicts of interest between FP-Ultra Clean, L.L.C. and us or our other stockholders may arise. Our amended and restated certificate of incorporation does not contain any provisions designed to facilitate resolution of actual or potential conflicts of interest or to ensure that potential business opportunities that may become available to both FP-Ultra Clean, L.L.C. and us will be reserved for, or made available to, us. If an actual or potential conflict of interest develops involving one of our directors, our corporate

Table of Contents

governance guidelines provide that the director must report the matter immediately to our board of directors and audit committee for evaluation and appropriate resolution. Further, such director must recuse himself or herself from participation in the related discussion and abstain from voting on the matter. Nonetheless, conflicts of interest may not be resolved in a manner favorable to us or our other stockholders. In addition, FP-Ultra Clean, L.L.C. and its director designees could delay or prevent an acquisition, merger or other transaction even if the transaction would benefit our other stockholders. In addition, FP-Ultra Clean, L.L.C. s significant concentration of share ownership may adversely affect the trading price of our common stock because investors often perceive disadvantages in owning stock in companies with controlling stockholders.

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

Future sales of our common stock by our controlling stockholder 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. are governed by an agreement with us that provides it demand and piggyback registration rights.

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.

In addition to the provisions of our stockholders agreement with FP-Ultra Clean, L.L.C. described above, 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.

Table of Contents

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Properties***

Our headquarters is located in Menlo Park, California, where we lease approximately 32,000 square feet of commercial space under a term lease that expires on December 31, 2007. We use this space for our principal administrative, sales and support, engineering and technology development facilities and for manufacturing purposes. Approximately 6,500 square feet at our Menlo Park facility is a clean room manufacturing facility. We also have manufacturing facilities in Austin, Texas, Tualatin, Oregon and Shanghai, China. In Austin, we lease approximately 22,080 square feet of commercial space under a lease that expires on October 31, 2008, subject to renewal for up to two years at our option. Approximately 3,500 square feet in Austin is a clean room manufacturing facility. In Tualatin, we lease approximately 22,000 square feet of commercial space under a lease that expires on November 7, 2007, subject to renewal for up to five years at our option. Approximately 4,000 square feet in Tualatin is a clean room manufacturing facility. In Shanghai, we lease approximately 52,000 square feet of commercial space under a lease that expires on June 30, 2009. Approximately 6,500 square feet in Shanghai is a clean room facility.

The table below lists our properties as of January 31, 2006.

Location	Principal Use	Square Footage	Ownership
Menlo Park, California	Headquarters, manufacturing, sales, engineering, technology development	32,000	Leased
Austin, Texas	Manufacturing, engineering	22,080	Leased
Tualatin, Oregon	Manufacturing, engineering	22,000	Leased
Shanghai, China	Manufacturing, customer support	52,000	Leased

Item 3. ***Legal Proceedings***

On September 2, 2005, we filed suit in the federal court for the Northern District of California against Celerity, Inc., or Celerity, seeking a declaratory judgment that our new substrate technology does not infringe certain of Celerity s patents and/or that Celerity s patents are invalid. On September 13, 2005, Celerity filed suit in the federal court of Delaware alleging that we have infringed 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 on December 12, 2005 was consolidated with our previously filed declaratory judgment action. The complaint by Celerity seeks injunction against future infringement of its patents and compensatory and treble damages. We believe that the claims made by Celerity are without merit and intend to defend the lawsuit vigorously. However, litigation can be costly and time consuming regardless of the outcome.

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

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

None.

Table of Contents

PART II

Item 5. *Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities*

Our common stock has been traded on the Nasdaq National Market under the symbol UCTT since March 25, 2004. The following table sets forth for the periods indicated the high and low closing sales prices per share of our common stock as reported by the Nasdaq National Market:

	High	Low
Fiscal year 2004		
First quarter (commencing March 25, 2004)	$ 7.50	$ 7.25
Second quarter	$ 8.30	$ 7.25
Third quarter	$ 7.49	$ 4.16
Fourth quarter	$ 6.19	$ 4.23
Fiscal year 2005		
First quarter	$ 6.80	$ 5.79
Second quarter	$ 7.96	$ 6.03
Third quarter	$ 7.41	$ 5.55
Fourth quarter	$ 7.63	$ 5.95

To date, we have not declared or paid cash dividends to our stockholders and we do not intend to do so for the foreseeable future in order to retain earnings for use in our business. In addition, our revolving credit facility and our stockholders agreement contain restrictions over our ability to pay dividends (see Note 3 Notes Payable and Borrowing Arrangements in Item 8 and Risk Factors Risks related to our ownership by Francisco Partners in Item 1A of this report). As of February 6, 2006, we had approximately 1,219 stockholders of record.

Table of Contents

Item 6. ***Selected Consolidated Financial Data***

You should read the following tables in conjunction with other information contained under Management s Discussion and Analysis of Financial Condition and Results of Operations, our consolidated financial statements and related notes and other financial information contained elsewhere in this Annual Report.

	Predecessor					
	As of or for the Year Ended December 31,			As of or for the Period from November 16 through December 31,	As of or for the Period from January 1 through November 15,	As of or for the Year Ended December 31,
	2005	2004	2003	2002	2002	2001
	(In thousands, except per share amounts)					
Consolidated statements of operations data:						
Net sales	$ 147,535	$ 184,204	$ 77,520	$ 7,916	$ 76,338	$ 76,486
Cost of goods sold	127,459	154,995	67,313	7,972	66,986	66,129
Gross profit (loss)	20,076	29,209	10,207	(56)	9,352	10,357
Operating expenses:						
Research and development	2,360	2,413	1,155	99	634	613
Sales and marketing	3,357	3,569	2,276	332	1,586	1,302
General and administrative	11,593	9,019	4,701	928	6,626	3,127
Stock and other deferred compensation	205	760	277	34		
In-process research and development				889		
Total operating expenses	17,515	15,761	8,409	2,282	8,846	5,042
Income (loss) from operations	2,561	13,448	1,798	(2,338)	506	5,315
Interest and other income (expense), net	147	(387)	(1,458)	(178)	(176)	(440)
Income (loss) before income taxes	2,708	13,061	340	(2,516)	330	4,875
Income tax provision (benefit)	705	4,511	232	(667)	642	1,981
Net income (loss)	$ 2,003	$ 8,550	$ 108	$ (1,849)	$ (312)	$ 2,894

Net income (loss) per share:						
Basic	$ 0.12	$ 0.59	$ 0.01	$ (0.21)	$ (0.08)	$ 0.79
Diluted	$ 0.12	$ 0.55	$ 0.01	$ (0.21)	$ (0.08)	$ 0.64
Shares used in computing net income (loss) per share:						
Basic	16,241	14,605	9,976	8,668	3,680	3,680
Diluted	17,169	15,542	10,711	8,668	3,680	4,535
Consolidated balance sheet data:						
Cash	$ 10,663	$ 11,440	$ 6,035	$ 6,237	$ 3,430	$ 760
Working capital	33,889	29,861	17,519	16,067	4,512	2,519
Total assets	75,009	67,698	50,155	48,836	27,086	20,652
Short- and long-term capital lease and other obligations	424	528	558	662	172	554
Debt to related parties			30,013	29,812	8,500	8,400
Total stockholders equity	$ 55,281	$ 52,475	$ 8,320	$ 8,089	$ 11,247	$ 8,670

Table of Contents

Item 7. *Management s Discussion and Analysis of Financial Condition and Results of Operations*

General

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. Currently, our revenue is derived primarily from the sale of gas delivery systems. We are increasing our revenue related to the sale of other subsystems, including chemical delivery modules, top-plate assemblies, frame assemblies and process modules. Our primary customers are semiconductor equipment manufacturers.

Historically the majority of semiconductor equipment manufacturers were vertically integrated. However, as they place greater emphasis on their core competencies, process development and innovation, they rely more heavily on outsourcing the design, development and manufacturing of many of the subsystems that comprise the semiconductor manufacturing equipment they produce. As the requirements they place on their subsystem suppliers increase and the scope of the subsystems they outsource expands, semiconductor equipment manufacturers seek to consolidate their supplier relationships into a reduced number of integrated solution providers.

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

A substantial majority of our products consists of gas delivery systems. Our other subsystems, related to semiconductor manufacturing equipment, include chemical delivery modules, top-plate assemblies, frame assemblies and process modules. We operate clean room manufacturing facilities in Menlo Park, California; Austin, Texas; Tualatin, Oregon; and Shanghai, China.

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

FP-Ultra Clean, L.L.C., an entity controlled by Francisco Partners, L.P., owns approximately 55% of our outstanding common stock. Pursuant to a stockholders agreement with FP-Ultra Clean, L.L.C., our board of directors may not take certain significant actions without the approval of FP-Ultra Clean, L.L.C. as long as it owns at least 25% of our outstanding common stock, including mergers, acquisitions or sales of assets outside the ordinary course of business, the issuance of securities and the incurrence or refinancing of indebtedness in excess of $10 million.

Cyclical Business

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. During these periods, we have experienced 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. In periods

where supply exceeds demand for semiconductor capital equipment, we generally experience significant reductions in customer orders for our products. Sharp decreases in demand for semiconductor capital equipment may lead our customers to cancel forecasted orders, change production quantities from forecasted volumes or delay production, each of which may negatively impact our gross profit as we may be unable to reduce costs quickly and may be required to hold inventory longer than anticipated. In periods where demand for semiconductor capital equipment exceeds supply, we typically need to quickly increase our production of gas delivery and other subsystems, requiring us to order additional inventory, effectively manage our component supply chain, hire additional employees and expand, if necessary, our manufacturing capacity.

Table of Contents

Outsourcing Need

We generate a significant portion of our revenue from the sale of gas delivery systems as well as a growing portion from other subsystems. The success of our business and our ability to generate future sales 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 a significant portion of their gas delivery systems. If OEMs do not continue to outsource gas delivery systems for their capital equipment, our revenue would be reduced, which could have a material adverse affect on our business, financial condition and operating results. In addition, if we are unable to obtain additional business as OEMs outsource their production of gas delivery and other subsystems, our business, financial condition and operating results could be adversely affected.

Customer and Geographic Concentration

A relatively small number of OEM customers have historically accounted for a significant portion of our revenue, 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, 92% of 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, reduction in, cancellation of or delay in purchase orders by, any one of these customers. Consolidation among our customers 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, any significant pricing pressure exerted by a key customer could adversely affect our operating results.

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