

ULTRA CLEAN HOLDINGS INC

Form 10-Q

May 05, 2014

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**Form 10-Q**

(Mark One)

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

For the quarterly period ended March 28, 2014

or

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

For the transition period from            to

Commission file number 000-50646

**Ultra Clean Holdings, Inc.**

(Exact name of registrant as specified in its charter)

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<b>Delaware</b> (State or other jurisdiction of incorporation or organization)	<b>61-1430858</b> (I.R.S. Employer Identification No.)
<b>26462 Corporate Avenue, Hayward, California</b> (Address of principal executive offices)	<b>94545</b> (Zip Code)
<b>(510) 576-4400</b>	
<b>Registrant's telephone number, including area code</b>	

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  No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

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

Large accelerated filer <input type="checkbox"/>	Accelerated filer <input checked="" type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

Number of shares outstanding of the issuer's common stock as of April 24, 2014: 29,442,612

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**Table of Contents****PART I. FINANCIAL INFORMATION****ITEM 1. Financial Statements****ULTRA CLEAN HOLDINGS, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited; in thousands, except share amounts)**

	<b>March 28, 2014</b>	<b>December 27, 2013</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 74,289	\$ 60,415
Accounts receivable, net of allowance of \$5 and \$5, respectively	72,197	67,450
Inventory	67,461	63,942
Deferred tax assets	4,072	4,071
Prepaid expenses and other	4,711	4,581
Total current assets	222,730	200,459
Equipment and leasehold improvements, net	8,167	8,534
Goodwill	55,918	55,918
Purchased intangibles, net	20,487	21,708
Deferred tax assets	5,259	5,341
Other non-current assets	374	583
Total assets	\$ 312,935	\$ 292,543
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Bank borrowings	\$ 48,825	\$ 37,705
Accounts payable	55,381	53,962
Accrued compensation and related benefits	5,519	5,730
Deferred rent, current portion	273	262
Other current liabilities	3,122	2,385
Total current liabilities	113,120	100,044
Long-term debt	14,924	17,421
Deferred rent and other liabilities	3,084	3,149
Total liabilities	131,128	120,614
Commitments and contingencies (See Note 7)		
Stockholders' equity:		
Preferred stock \$0.001 par value, 10,000,000 authorized; none outstanding		
Common stock \$0.001 par value, 90,000,000 authorized; 29,342,974 and 28,694,762 shares issued and outstanding, in 2014 and 2013, respectively	29	29
Additional paid-in capital	150,700	147,876
Common shares held in treasury, at cost, 601,944 shares	(3,337)	(3,337)

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Retained earnings	34,415	27,361
Total stockholders' equity	181,807	171,929
Total liabilities and stockholders' equity	\$ 312,935	\$ 292,543

(See accompanying notes to condensed consolidated financial statements)

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

	<b>Three months ended</b>	
	<b>March 28, 2014</b>	<b>March 29, 2013</b>
Sales	\$ 144,224	\$ 100,464
Cost of goods sold	120,913	86,641
<b>Gross profit</b>	<b>23,311</b>	<b>13,823</b>
Operating expenses:		
Research and development	1,767	1,257
Sales and marketing	2,661	2,319
General and administrative	9,722	9,626
<b>Total operating expenses</b>	<b>14,150</b>	<b>13,202</b>
<b>Income from operations</b>	<b>9,161</b>	<b>621</b>
Interest and other income (expense), net	(629)	(957)
<b>Income (loss) before provision (benefit) for income taxes</b>	<b>8,532</b>	<b>(336)</b>
Income tax provision (benefit)	1,476	(25)
<b>Net income (loss)</b>	<b>\$ 7,056</b>	<b>\$ (311)</b>
Net income (loss) per share:		
Basic	\$ 0.24	\$ (0.01)
Diluted	\$ 0.24	\$ (0.01)
Shares used in computing net income (loss) per share:		
Basic	28,877	27,978
Diluted	29,918	27,978

(See accompanying notes to condensed consolidated financial statements)

**Table of Contents****ULTRA CLEAN HOLDINGS, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(unaudited; in thousands)**

	<b>Three months ended</b>	
	<b>March 28, 2014</b>	<b>March 29, 2013</b>
<b>Cash flows from operating activities:</b>		
Net income (loss)	\$ 7,056	\$ (311)
<b>Adjustments to reconcile net income (loss) to net cash provided by operating activities:</b>		
Depreciation and amortization	747	806
Amortization of finite lived intangibles	1,221	1,499
Amortization of debt issuance costs	122	122
Excess tax benefit from stock-based compensation	(1,404)	(71)
Stock-based compensation	1,019	1,320
<b>Changes in assets and liabilities:</b>		
Accounts receivable	(4,747)	599
Inventory	(3,519)	2,794
Prepays and other	(130)	127
Deferred income taxes	81	
Other non-current assets	209	4
Accounts payable	1,483	10,993
Accrued compensation and related benefits	(211)	(1,417)
Income taxes payable	1,405	
Other liabilities	684	(198)
<b>Net cash provided by operating activities</b>	<b>4,016</b>	<b>16,267</b>
<b>Cash flows from investing activities:</b>		
Purchases of equipment and leasehold improvements	(512)	(245)
Proceeds from sale of equipment	66	
<b>Net cash used in investing activities</b>	<b>(446)</b>	<b>(245)</b>
<b>Cash flows from financing activities:</b>		
Proceeds from revolving credit facility	11,000	14,000
Principal payments on term debt	(2,500)	(19,002)
Excess tax benefit from stock-based compensation	1,404	71
Net settlement of common stock	(1,334)	(507)
Proceeds from issuance of common stock	1,734	48
<b>Net cash provided by (used in) financing activities</b>	<b>10,304</b>	<b>(5,390)</b>
<b>Net increase in cash</b>	<b>13,874</b>	<b>10,632</b>
<b>Cash and cash equivalents at beginning of period</b>	<b>60,415</b>	<b>54,311</b>
<b>Cash and cash equivalents at end of period</b>	<b>\$ 74,289</b>	<b>\$ 64,943</b>
<b>Supplemental items:</b>		
<b>Cash paid during the period:</b>		
Income taxes paid	\$ 918	\$ 218
Income tax refunds	\$ 1,356	\$
Interest	\$ 564	\$ 726
<b>Non-cash activities:</b>		

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Fixed asset purchased included in accounts payable	\$	114	\$	122
(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 and Significant Accounting Policies**

*Organization* Ultra Clean Holdings, Inc. (Ultra Clean or the Company) was founded in November 2002 for the purpose of acquiring Ultra Clean Technology Systems and Service Inc. Ultra Clean Technology Systems and Service, Inc. was founded in 1991 by Mitsubishi Corporation and was operated as a subsidiary of Mitsubishi until November 2002, when it was acquired by Ultra Clean. Ultra Clean became a publicly traded company in March 2004. In June 2006, the Company completed the acquisition of Sieger Engineering, Inc. to better enhance its position as a subsystem supplier to the semiconductor, research, flat panel, energy and medical equipment industries. Ultra Clean Technology (Shanghai) Co., Ltd and Ultra Clean Micro-Electronics Equipment (Shanghai) Co., Ltd. were established in 2005 and 2007, respectively, to facilitate the Company's operations in China. Ultra Clean Asia Pacific, Pte. Ltd. (Singapore), was established in fiscal year 2008 to facilitate the Company's operations in Singapore. In July 2012, the Company acquired American Integration Technologies LLC (AIT) to immediately add to the Company's customer base in the semiconductor and medical spaces and to provide additional manufacturing capabilities. The Company operates in one reportable segment. See Note 8 to the Condensed Consolidated Financial Statements.

The Company is a leading developer and supplier of critical subsystems, for Original Equipment Manufacturers (OEMs) primarily in the semiconductor, industrial, flat panel, medical, energy and research industries. The Company develops, designs, prototypes, engineers, manufactures and tests systems and subsystems which are highly specialized and integral to the Company's customer products.

The Company provides its customers with complete solutions that combine its expertise in design, test, component characterization and highly flexible global manufacturing operations with excellence in quality control and financial stability. The Company's global presence and supply chain management helps the Company to drive down total manufacturing costs, reduce design-to-delivery cycle times and maintain high quality standards for the Company's customers. The Company believes that these characteristics provide global solutions for the Company's customers growing product demands.

The Company ships a majority of its products to U.S. registered customers with locations both in the U.S. and outside the U.S. In addition to US manufacturing, the Company manufactures products in its Asian facilities to support local and US based customers. The Company conducts its operating activities primarily through its wholly owned subsidiaries: Ultra Clean Technology Systems and Service, Inc., AIT LLC, Ultra Clean Technology (Shanghai) Co., Ltd., Ultra Clean Micro-Electronics Equipment (Shanghai) Co., Ltd. and Ultra Clean Asia Pacific, Pte Ltd. (Singapore). The Company's international sales represented 26.7% and 17.2% of sales for the periods ended March 28, 2014 and March 29, 2013, respectively. See Note 8 to the Company's Condensed Consolidated Financial Statements for further information about the Company's geographic areas.

*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. Certain information and footnote disclosures normally included in our annual financial statements, prepared in accordance with GAAP, have been condensed or omitted. The Company's December 27, 2013, balance sheet data was derived from audited financial statements as of that date.

*Principles of Consolidation* The Company's condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries and all intercompany accounts and transactions have been eliminated in consolidation. The Company uses a 52-53 week fiscal year ending on the Friday nearest December 31. All references to quarters refer to fiscal quarters and all references to years refer to fiscal years.

*Foreign Currency Translation* The Company has reviewed its non-U.S. subsidiaries (of which all of its non-U.S. asset base resides in Asia) that operate in a local currency environment to determine their functional currency by examining how and in what currency each subsidiary generates cash through billings and cash receipts and how and in what currency the subsidiary expends cash through payment of its vendors and payment of its workforce. Also, these subsidiaries' individual assets and liabilities that are primarily denominated in the local foreign currency are examined for their impact on the Company's cash flows. All have been determined to have the U.S. dollar as its functional currency. All balance sheet accounts of these local functional currency subsidiaries are translated at the fiscal period-end exchange rate, and income and

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expense accounts are translated using average rates in effect for the period, except for costs related to those balance sheet items that are translated using historical exchange rates. Foreign currency transaction gains and losses are recorded in interest and other income (expense), net.

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*Use of Accounting Estimates* The presentation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and disclosures of contingent liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Such estimates and assumptions include reserves on inventory, valuation of deferred tax assets and impairment of goodwill and other long-lived assets. The Company bases its estimates and judgments on historical experience and on various other assumptions that it believes are reasonable under the circumstances. However, future events are subject to change and the best estimates and judgments routinely require adjustment. Actual amounts may differ from those estimates.

*Certain Significant Risks and Uncertainties* The Company operates in a dynamic industry and, accordingly, can be affected by a variety of factors. For example, any of the following areas could have a negative effect on the Company in terms of its future financial position, results of operations or cash flows: the general state of the U.S. and world economies, the highly cyclical nature of the industries the Company serves; the loss of any of a small number of customers; ability to obtain additional financing; inability to meet certain debt covenants; failure to successfully integrate completed acquisitions; ineffectiveness in pursuing acquisition opportunities; regulatory changes; fundamental changes in the technology underlying semiconductor, flat panel, solar and medical device manufacturing processes or manufacturing equipment; the hiring, training and retention of key employees; successful and timely completion of product design efforts; and new product design introductions by competitors.

*Concentration of Credit Risk* Financial instruments which subject the Company to concentrations of credit risk consist principally of cash and cash equivalents and accounts receivable. The Company sells its products primarily to semiconductor capital equipment manufacturers in the United States. The Company performs credit evaluations of its customers' financial condition and generally requires no collateral.

*Significant sales to customers* The Company had significant sales to three customers which accounted for 10% or more of sales for the three months ended March 28, 2014. The Company had significant sales to four customers, each of which accounted for 10% or more of sales for the three months ended March 29, 2013. Sales to each of these customers as a percentage of total sales were as follows:

	Three months ended	
	March 28, 2014	March 29, 2013
Lam Research Corporation	34.3%	28.6%
Applied Materials, Inc.	25.3%	36.9%
ASM International	19.4%	12.3%
Intuitive Surgical, Inc.	*%	10.6%
<b>Total</b>	<b>79.0%</b>	<b>88.4%</b>

\*Sales to this customer were less than 10% for the three months ended March 28, 2014.

Three customers' accounts receivable balances: Applied Materials, Inc., Lam Research Corporation and ASM International were individually greater than 10% of accounts receivable and, in the aggregate, represented approximately 76% and 82% of accounts receivable as of March 28, 2014 and December 27, 2013, respectively.

*Fair Value of Financial Instruments*-The Company's financial instruments consist of cash and cash equivalents, accounts receivable, accounts payable and bank borrowings. The carrying value of cash and cash equivalents, accounts receivable and accounts payable approximates their fair value because of their short-term nature.

The accounting guidance for fair value measurements prioritizes the inputs used in measuring fair value in the following hierarchy:

Level 1 Quoted prices in active markets for identical assets or liabilities,

Level 2 Observable inputs other than the Level 1 prices for similar assets or liabilities; quoted prices in active markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of assets or liabilities,

Level 3 Unobservable inputs in which there is little or no market data, and that are significant to the fair value of the assets or liabilities.



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The Company's only financial asset measured at fair value on a recurring basis is an overnight sweep account invested in money market funds with maturities of less than 90 days from purchase and are thus classified as cash and cash equivalents on the Company's balance sheet. These money market funds had a carrying value and fair value of \$10.0 million at March 28, 2014 based on Level 2 inputs. The Company's financial liabilities measured at fair value are related to the Company's credit facility. Specifically, the fair value of the Company's long term debt was based on level 2 inputs and fair value was determined using quoted prices for similar liabilities in inactive markets. The fair value of the Company's outstanding borrowings under the Company's revolving credit facility were based on level 2 inputs and fair value was determined using inputs other than quoted prices that are observable, specifically, discounted cash flows of expected payments at current borrowing rates. The Company's carrying value approximates fair value for the Company's long term debt and revolving credit facility.

Financial assets and liabilities measured at fair value are summarized below (in thousands):

	<b>Quoted Prices in Active Markets for Identical Assets March 28, 2014 (level 1)</b>	<b>Significant Other Observable Inputs (level 2)</b>	<b>Quoted Prices in Active Markets for Identical Assets December 27, 2013 (level 1)</b>	<b>Significant Other Observable Inputs (level 2)</b>
Money market fund deposits (1)	\$ 10,043		\$ 13,414	

- (1) Included in cash and cash equivalents on the condensed consolidated balance sheet. The carrying amounts approximate fair value due to the short-term maturities of the cash equivalents.

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

Income tax positions must meet a more-likely-than-not recognition threshold to be recognized. Income tax positions that previously failed to meet the more-likely-than-not threshold are recognized in the first subsequent financial reporting period in which that threshold is met. Previously recognized tax positions that no longer meet the more-likely-than-not threshold are derecognized in the first subsequent financial reporting period in which that threshold is no longer met. The Company recognizes potential accrued interest and penalties related to unrecognized tax benefits within the consolidated statements of income as income tax expense.

The determination of the Company's tax provision is subject to judgments and estimates. The carrying value of the Company's net deferred tax assets, which is made up primarily of tax deductions, assumes it will be able to generate sufficient future income to fully realize these deductions. In determining whether the realization of these deferred tax assets may be impaired, the Company makes judgments with respect to whether it is likely to generate sufficient future taxable income to realize these assets. The Company has a valuation allowance on the deferred tax assets of one of its China subsidiaries in the amount of \$654,000 as of March 28, 2014 and December 27, 2013, respectively.

The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with the Company's expectations could have a material impact on its results of operations and financial position. Management believes that it has adequately provided for any adjustments that may result from these examinations, however, the outcome of tax audits cannot be predicted with certainty.

**Product Warranty** The Company provides a warranty on its products for a period of up to two years and provides for warranty costs at the time of sale based on historical activity. The determination of such provisions requires the Company to make estimates of product return rates and expected costs to repair or replace the products under warranty. If actual return rates and/or repair and replacement costs differ significantly from these estimates, adjustments to cost of sales may be required in future periods. Components of the reserve for warranty costs consisted of the following (in thousands):

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	Three months ended	
	March 28, 2014	March 29, 2013
Beginning balance	\$ 101	\$ 152
Change in reserve	67	(17)
Warranty costs incurred in the current period	(57)	(20)
Ending balance	\$ 111	\$ 115

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**Revenue Recognition** Product revenue is generally recorded upon shipment. In arrangements which specify title transfer upon delivery, revenue is not recognized until the product is delivered. The Company recognizes revenue when persuasive evidence of an arrangement exists, shipment has occurred, price is fixed or determinable and collectability is reasonably assured. If the Company has not substantially completed a product or fulfilled the terms of a sales agreement at the time of shipment, revenue recognition is deferred until fulfillment. The Company's standard arrangement for its customers includes a signed purchase order or contract, no right of return of delivered products and no customer acceptance provisions. The Company assesses collectability based on the credit worthiness of the customer and past transaction history. The Company performs on-going credit evaluations of customers and generally does not require collateral from customers.

**Research and Development Costs** Research and development costs are expensed as incurred.

**Net Income (Loss) per Share** Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of shares outstanding for the period. Diluted net income (loss) per share is calculated by dividing net income (loss) by the weighted average number of common shares outstanding and common equivalent shares from dilutive stock options and restricted stock using the treasury stock method, except when such shares are anti-dilutive (see Note 6 to condensed consolidated financial statements).

**Comprehensive Income (Loss)** The Company reports by major components and as a single total, the change in its net assets during the period from non-owner sources. Comprehensive income for all periods presented was the same as net income.

**Segments** The Financial Accounting Standards Board's (FASB) guidance regarding disclosure about segments in an enterprise and related information establishes standards for the reporting by public business enterprises of information about reportable segments, products and services, geographic areas, and major customers. The method for determining what information to report is based on the manner in which management organizes the reportable segments within the Company for making operational decisions and assessments of financial performance. The Company's chief operating decision-maker is considered to be the Chief Executive Officer. The Company operates in one reporting segment.

**Business Combinations** The Company recognizes assets acquired (including goodwill and identifiable intangible assets) and liabilities assumed at fair value on the acquisition date. Subsequent changes to the fair value of such assets acquired and liabilities assumed are recognized in earnings, after the expiration of the measurement period, a period not to exceed 12 months from the acquisition date. Acquisition-related expenses and acquisition-related restructuring costs are recognized in earnings in the period in which they are incurred.

***Stock-Based Compensation Expense***

The Company maintains stock-based compensation plans which allow for the issuance of equity-based awards to executives and certain employees. These equity-based awards include stock options, restricted stock awards (RSAs) and restricted stock units (RSUs) which can be either time-based or performance-based. The Company also maintains an employee stock purchase plan that provides for the issuance of shares to all eligible employees of the Company at a discounted price.

Stock-based compensation expense includes compensation costs related to estimated fair values of stock options and awards granted. The estimated fair value of the Company's equity-based awards, net of expected forfeitures, is amortized over the awards' vesting period on a straight-line basis over a weighted average period of four years for stock options, three years for restricted stock units and one year for restricted stock awards, and will be adjusted for subsequent changes in estimated forfeitures related to all equity-based awards and performance as it relates to performance-based RSUs.

The Company applies the fair value recognition provisions based on the FASB's guidance regarding stock-based compensation. The exercise price of each stock option equals the market price of the Company's stock on the date of grant. Most options are scheduled to vest over four years and expire no later than ten years from the grant date. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The determination of the fair value of share-based payment awards on the date of grant using an option-pricing model is affected by the Company's stock price as well as assumptions regarding certain variables. These variables include the expected term of the awards; the Company's expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rate and expected dividends. The Company estimates the expected term of share-based awards granted based on the Company's historical option term experience. The Company estimates the volatility of its common stock based upon the Company's historical stock price volatility over the length of the expected term of the options. The Company bases the risk-free interest rate that it uses in the option valuation model on U.S. Treasury zero-coupon issues with remaining maturities similar to the expected term of the options. The Company does not anticipate paying any cash dividends in the foreseeable future and therefore uses an expected dividend yield of zero in the option valuation model. The Company is required to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and records share-based compensation expense only for those awards that are expected to vest. The Company also considers, each quarter, whether there

have been any significant changes in facts and circumstances that would affect its estimated forfeiture rate.



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Stock option activity for the three months ended March 28, 2014:

	Number of Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 27, 2013	1,209,119	\$ 7.86	2.86	\$ 3,976
Granted				
Exercised	(337,997)	\$ 5.13		
Canceled	(1,846)	\$ 13.42		
Outstanding at March 28, 2014	869,276	\$ 8.91	2.43	\$ 3,701
Options exercisable and expected to vest at March 28, 2014	869,276	\$ 8.91	2.43	\$ 3,701

There were no options granted by the Company during either of the three month periods ended March 28, 2014 and March 29, 2013.

As of March 28, 2014, there was no unamortized expense as all outstanding options were fully vested.

**Employee Stock Purchase Plan**

The Company also maintains an employee stock purchase plan ( ESPP ) that provides for the issuance of shares to all eligible employees of the Company at a discounted price. Under the ESPP, substantially all employees may purchase the Company s common stock through payroll deductions at a price equal to 95 percent of the fair market value of the Company s stock at the end of each applicable purchase period.

**Restricted Stock Units and Restricted Stock Awards**

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

**Restricted Stock Units** RSU s are granted to employees with a per share or unit purchase price of zero dollars and either have time based or performance based vesting. RSU s typically vest over three years, subject to the employee s continued service with the Company. For purposes of determining compensation expense related to these RSU s, the fair value is determined based on the closing market price of the Company s common stock on the date of award. The expected cost of the grant is reflected over the service period, and is reduced for estimated forfeitures. During the quarter ended March 28, 2014, the Company granted 303,875 RSU s, with a weighted average fair value of \$13.16 per share, and granted 160,625 performance stock units with a weighted average fair value of \$13.33 per share. During the three months ended March 28, 2014, 97,028 vested shares were withheld to satisfy withholding tax obligations, resulting in the net issuance of 648,212 shares. As of March 28, 2014, approximately \$6.7 million of stock-based compensation cost, net of estimated forfeitures, related to RSU s remains to be amortized over a weighted average period of two years. As of March 28, 2014, a total of 1,036,665 RSU s remain outstanding with an aggregate intrinsic value of \$13.0 million and a weighted average remaining contractual term of 1.46 years.

**Restricted Stock Awards** As of March 28, 2014, a total of 30,000 RSA s remain outstanding. The total unamortized expense of the Company s unvested restricted stock awards as of March 28, 2014, was less than \$0.1 million.

The following table summarizes the Company s restricted stock unit and restricted stock award activity for the three months March 28, 2014:

	Number of Shares	Aggregate
--	------------------	-----------

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		<b>Intrinsic Value (in thousands)</b>
Unvested restricted stock units and restricted stock awards at December 27, 2013	1,256,930	\$ 12,632
Granted	464,500	
Vested	(407,243)	
Forfeited	(247,522)	
Unvested restricted stock units and restricted stock awards at March 28, 2014	1,066,665	\$ 12,927
Vested and expected to vest restricted stock units and restricted stock awards at March 28, 2014	871,359	\$ 10,866

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The following table shows the Company's stock-based compensation expense included in the condensed consolidated statements of operations (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Cost of sales (1)	\$ 326	\$ 417
Research and development	71	88
Sales and marketing	132	132
General and administrative	490	683
	1,019	1,320
Income tax benefit	(176)	(223)
<b>Total stock-based compensation expense, net of income tax benefit</b>	<b>\$ 843</b>	<b>\$ 1,097</b>

(1) Stock-based compensation expenses capitalized in inventory for fiscal quarter March 28, 2014 and March 29, 2013 were considered immaterial.

**2. Balance Sheet Information**

Inventory is stated at the lower of standard cost or market and consisted of the following (in thousands):

	March 28, 2014	December 27, 2013
Raw materials	\$ 47,298	\$ 49,515
Work in process	21,561	19,437
Finished goods	5,167	1,815
Ending Inventory	74,026	70,767
Reserve for excess and obsolete	(6,565)	(6,825)
<b>Total</b>	<b>\$ 67,461</b>	<b>\$ 63,942</b>

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

	March 28, 2014	December 27, 2013
Computer equipment and software	\$ 8,422	\$ 8,280
Furniture and fixtures	2,472	2,411
Machinery and equipment	9,282	9,249
Leasehold improvements	10,669	10,583
	30,845	30,523
Accumulated depreciation and amortization	(22,678)	(21,989)
<b>Total</b>	<b>\$ 8,167</b>	<b>\$ 8,534</b>

**3. Goodwill and Purchased Intangible Assets**

The Company's methodology for allocating the purchase price relating to purchase acquisitions is determined through established and generally accepted valuation techniques. Goodwill is measured as the excess of the cost of the acquisition over the

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sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment at least annually and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. The Company regularly monitors current business conditions and other factors including, but not limited to, adverse industry or economic trends and lower projections of profitability that may impact future operating results.

To test goodwill for impairment, the Company first performs a qualitative assessment to determine whether it is more likely than not that the fair value of a reporting unit is less than its carrying value. If it is concluded that this is the case, the Company then performs the two-step goodwill impairment test. Otherwise, the two-step goodwill impairment test is not required. Under the two-step goodwill impairment test, the Company would in the first step compare the estimated fair value of each reporting unit to its carrying value. The Company determines the fair value of each of its reporting units based on a weighting of income and market approaches. If the carrying value of a reporting unit exceeds its fair value, the Company would then perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the Company determines that the carrying value of a reporting unit's goodwill exceeds its implied fair value, the Company would record an impairment charge equal to the difference.

The evaluation of goodwill and intangible assets for impairment requires the exercise of significant judgment. In the event of future changes in business conditions, the Company will be required to reassess and update its forecasts and estimates used in future impairment analyses. If the results of these future analyses are lower than current estimates, a material impairment charge may result at that time.

Details of goodwill and other intangible assets were as follows (in thousands):

	March 28, 2014			December 27, 2013		
	Intangible		Total	Intangible		Total
	Goodwill	Assets		Goodwill	Assets	
Carrying amount	\$ 55,918	\$ 20,487	\$ 76,404	\$ 55,918	\$ 21,708	\$ 77,626
<i>Purchased Intangible Assets</i>						

Intangible assets are generally recorded in connection with a business acquisition. The Company evaluates the useful lives of its intangible assets each reporting period to determine whether events and circumstances require revising the remaining period of amortization. In addition, the Company reviews indefinite lived intangible assets for impairment when events or changes in circumstances indicate their carrying value may not be recoverable and tests definite lives intangible assets at least annually for impairment. Management considers such indicators as significant differences in product demand from the estimates, changes in the competitive and economic environment, technological advances, and changes in cost structure.

Details of purchased intangible assets were as follows (in thousands):

	As of March 28, 2014			As of December 27, 2013			Useful Life (in years)
	Gross		Carrying Value	Gross		Carrying Value	
	Carrying Amount	Accumulated Amortization		Carrying Amount	Accumulated Amortization		
Customer relationships	\$ 19,000	\$ (9,826)	\$ 9,174	\$ 19,000	\$ (8,764)	\$ 10,236	7
Tradename (AIT)	\$ 1,900	\$ (774)	\$ 1,126	\$ 1,900	\$ (672)	\$ 1,228	6
Intellectual property know-how	\$ 1,600	\$ (400)	\$ 1,200	\$ 1,600	\$ (343)	\$ 1,257	7
Tradename (UCT)	\$ 8,987	\$	\$ 8,987	\$ 8,987	\$	\$ 8,987	*
	\$ 31,487	\$ (11,000)	\$ 20,487	\$ 31,487	\$ (9,779)	\$ 21,708	

The Company amortizes its tradename (AIT) and customer relationships intangible assets using an accelerated method over the estimated economic life of the assets, ranging from 6 to 7 years. The Company amortizes its intellectual property/know-how intangible asset on a straight-line basis with an estimated economic life of seven years. Amortization expense was approximately \$1.2 million and \$1.5 million for the three months ended March 28, 2014 and March 29, 2013, respectively. Amortization expense is charged to General and Administrative. As of

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March 28, 2014, future estimated amortization expense is expected to be as follows (in thousands):

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	<b>Amortization Expense</b>
2014 (remaining in year)	\$ 3,662
2015	2,813
2016	2,293
2017	1,386
2018	848
thereafter	498
<b>Total</b>	<b>\$ 11,500</b>

\* In addition to the AIT tradename intangible of \$1.9 million, the Company is also carrying a UCT tradename intangible asset of \$9.0 million as a result of a previous acquisition. The Company concluded that the UCT tradename intangible asset life is indefinite and is therefore not amortized.

**4. Borrowing Arrangements**

On July 3, 2012, in connection with the Company's acquisition of AIT and the refinancing of its prior credit facility, the Company entered into a credit agreement (the "Credit Agreement") by and among the Company, certain of its subsidiaries, Silicon Valley Bank, U.S. Bank National Association and HSBC Bank (collectively, the "Lenders"). The Credit Agreement provides for a term loan in an aggregate principal amount of \$40.0 million (the "Term Loan") and a revolving credit facility in an aggregate principal amount of \$40.0 million (the "Revolving Credit Facility"), a letter of credit facility in the aggregate availability amount of \$15.0 million (as a sublimit of such Revolving Credit Facility) (the "L/C Facility") and a swing line sub-facility in the aggregate availability amount of \$4.0 million (as a sublimit of the Revolving Credit Facility) (together with the Term Loan, the Revolving Credit Facility and the L/C Facility, the "Credit Facility"). On July 3, 2012, the Company borrowed an aggregate of \$40.0 million under the Term Loan and approximately \$39.8 million under the Revolving Credit Facility. The borrowed funds were used at the closing of the Company's acquisition of AIT to finance the acquisition and repay the outstanding balance of \$3.7 million to Silicon Valley Bank as lender under the Company's prior credit facility. The prior credit facility was terminated in connection with this transaction.

The Credit Facility must be repaid in consecutive quarterly installments of \$2.5 million, with the first payment made on September 30, 2012, and with the balance of the then-outstanding principal amount due at the final maturity, which is July 3, 2016. The Revolving Credit Facility is available for the four-year period beginning on July 3, 2012. The Credit Agreement includes customary representations, warranties, covenants and events of default. The Company and certain of its subsidiaries have agreed to secure all of their obligations under the Credit Agreement by granting a first priority lien in substantially all of their respective personal property assets of these entities (subject to certain exceptions and limitations).

At the Company's option, borrowings under the Term Loan and Revolving Credit Facility (subject to certain limitations) bear interest at either a base rate or at the London Interbank Offered Rate ("LIBOR") (with the LIBOR being adjusted for certain Eurocurrency reserve requirements, if any, as described in the Credit Agreement), plus, in each case, an applicable margin based on the Company's consolidated leverage ratio. All loans described above made on July 3, 2012 were initially base rate loans, carrying interest of 3.75%. As of March 28, 2014, the interest rates on the Term Loan and Revolving Credit Facility were 3.67% and 3.75%, respectively. The effective interest rates will be slightly higher due to the incurrence of certain loan-related costs of approximately \$1.9 million that are treated as deferred interest and amortized over the life of the loan.

The Credit Agreement requires the Company to maintain certain financial covenants including a minimum consolidated fixed charge coverage ratio, a maximum consolidated leverage ratio and minimum domestic cash balances. On February 15, 2013, the Company and the Lenders amended the Credit Agreement in order to modify the financial covenants contained in the Credit Agreement, effective January 30, 2013. The Credit Agreement, as amended, requires the Company to comply with the following financial covenants:

a minimum consolidated fixed charge coverage ratio (as defined in the Credit Agreement, as amended), measured over the preceding four fiscal quarters, beginning as of the end of the third quarter of fiscal 2014, of 1.10 to 1.00, stepping up to 1.25 to 1.00 as of the end of each fiscal quarter beginning with the first quarter of fiscal 2015 and thereafter;

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a maximum consolidated leverage ratio (as defined in the Credit Agreement, as amended) measured over the preceding four fiscal quarters, beginning, as of the end of the third quarter of fiscal 2014, of 4.00 to 1.00, stepping down to 3.75 to 1.00 as of the end of the fourth quarter of fiscal 2014 and thereafter to and including the third quarter of 2015, and 3.25 to 1.00 as of the end of each fiscal quarter beginning with the fourth quarter of 2015 and thereafter;

minimum domestic cash of \$15.0 million as of the last day of any fiscal quarter and \$10.0 million as of the last day of any other fiscal month from January 25, 2013 and thereafter;

a minimum consolidated quick ratio (as defined in the Credit Agreement, as amended) of 1.10 to 1.00 as of the end of each fiscal month from January 25, 2013 and thereafter;

minimum consolidated adjusted EBITDA (as defined in the Credit Agreement, as amended), measured over the preceding two quarters, of \$6.0 million as of the end of the fourth quarter of 2013, \$7.0 million as of the end of the first quarter of 2014 and \$8.0 million as of the end of the second quarter of 2014 and each quarter thereafter.

The Company was in compliance with all covenants for the quarter ended March 28, 2014.

The Credit Agreement contains provisions requiring the following mandatory prepayments (subject to certain exceptions and limitations): (i) prepayments equal to 50% of the net cash proceeds from the issuance of capital stock by the Company's primary operating subsidiary (or any of its subsidiaries); (ii) prepayments equal to 100% of the net cash proceeds from the incurrence of any indebtedness by the Company's primary operating subsidiary over \$250,000; (iii) prepayments equal to the net cash proceeds from certain asset sales or insurance or condemnation recoveries; and (iv) annual prepayments in an amount equal to (a) 33% of excess cash flow (as defined in the Credit Agreement, as amended) if the aggregate outstanding principal amount of the Term Loan equals or exceeds \$20.0 million and (b) 25% of excess cash flow if the aggregate outstanding principal amount of the Term Loan equals or exceeds \$10.0 million but is less than \$20.0 million.

The Credit Agreement also restricts the Company from declaring or paying any cash dividends.

As of March 28, 2014, the outstanding amounts under the Company's Term Loan and Revolving Credit Facility were \$25.0 million and \$39.8 million, respectively, which are net of unamortized debt issuance costs of \$1.1 million for a total debt balance of \$63.7 million. The Company analyzed the Credit Agreement and determined that the outstanding balance of Revolving Credit Facility debt should be classified as short-term due to acceleration clauses in the agreement.

## **5. Income Tax**

The Company's income tax provision (benefit) and related effective tax rate for the three month periods ended March 28, 2014 and March 29, 2013, respectively, was \$1.5 million and 17.3% and \$(25,000) and (7.4)%, respectively. The change in respective rates reflects, primarily, changes in the geographic mix of worldwide earnings and financial results for the three month period ended March 28, 2014 compared to the same period in 2013.

The Company earns a significant amount of its operating income outside the United States, which is deemed to be indefinitely reinvested in foreign jurisdictions. As a result, most of the Company's cash is held by foreign subsidiaries. The Company currently does not intend nor foresee a need to repatriate these funds to the U.S. The Company expects existing domestic cash and cash flows from operations to continue to be sufficient to fund its domestic operating activities and cash commitments for investing and financing activities, such as debt repayment and capital expenditures, for at least the next 12 months and thereafter for the foreseeable future. If the Company should require more capital in the U.S. than is generated by its domestic operations, for example to fund significant discretionary activities such as business acquisitions, the Company could elect to repatriate future earnings from foreign jurisdictions or raise capital in the United States through debt or equity issuances. These alternatives could result in higher effective tax rates, increased interest expense, or dilution of our earnings. The Company has borrowed funds domestically and continues to believe it will have the ability to do so at reasonable interest rates. The Company does not provide for U.S. taxes on its undistributed earnings of foreign subsidiaries that it intends to invest indefinitely outside the U.S., unless such taxes are otherwise required under U.S. tax law. In 2013, the Company determined that a portion of the current year and future year earnings of one its China subsidiaries may be remitted in the future to one of its foreign subsidiaries outside of Mainland China and, accordingly, the Company provided for the related withholding taxes in its condensed consolidated financial statements. If the Company changes its intent to reinvest its undistributed foreign earnings indefinitely or if a greater amount of undistributed earnings are needed than the previous anticipated remaining unremitted foreign earnings, the Company could be required to accrue or pay U.S. taxes on some or all of these undistributed earnings. As of



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March 28, 2014, the Company had undistributed earnings of foreign subsidiaries that are indefinitely invested outside of the U.S. of approximately \$47.3 million. It is not practicable to determine the income tax liability that might be incurred if these earnings were to be distributed.

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The following table summarizes the activity related to the Company's unrecognized tax benefits (in thousands):

	Three months ended	
	March 28, 2014	March 29, 2013
Balance as of the beginning of period	\$ 165	\$ 109
Increases related to prior year tax positions	10	
<b>Balance as of the end of period</b>	<b>\$ 175</b>	<b>\$ 109</b>

The Company's gross liability for unrecognized tax benefits as of March 28, 2014 and December 27, 2013 was \$175,000 and \$165,000, respectively. Increases or decreases to interest and penalties on uncertain tax positions are included in income tax provision (benefit) in the condensed consolidated statements of operations. Interest related to uncertain tax positions was \$1,000 for each of the three months ended March 28, 2014 and March 29, 2013, respectively. Although it is possible some of the unrecognized tax benefits could be settled within the next twelve months, the Company cannot reasonably estimate the outcome at this time.

The determination of the Company's tax provision is subject to judgments and estimates. The carrying value of the Company's net deferred tax assets, which is made up primarily of tax deductions, assumes the Company will be able to generate sufficient future income to fully realize these deductions. In determining whether the realization of these deferred tax assets may be impaired, the Company makes judgments with respect to whether the Company is likely to generate sufficient future taxable income to realize these assets. In addition, the calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with the Company's expectations could have a material impact on the Company's results of operations and financial position.

As of March 28, 2014, the Company maintained a full valuation allowance on one of its China subsidiaries in the amount of \$0.7 million as the Company believes it is more likely than not that the deferred tax asset will not be realized. In order to reverse a valuation allowance, accounting principles generally accepted in the United States of America suggest that the Company review the cumulative income/loss in recent years as well as determine the Company's ability to generate sufficient future taxable income to realize the Company's net deferred tax assets.

The Company files income tax returns in the U.S. federal jurisdiction, various states and foreign jurisdictions. The Company's 2010 through 2012 federal income tax returns are open to audit through the statute of limitations by the Internal Revenue Service. The Company's 2009 through 2012 state income tax returns are open to audit by the California Franchise Tax Board. The Company is also subject to examination in various other jurisdictions for various periods. The Company is currently experiencing a tax holiday related to its Singapore subsidiary that will expire for tax years beginning January 2015. The Company's Singapore subsidiary recorded a net profit of \$2.7 million for the three months ended March 28, 2014.

**6. Net Income (Loss) Per Share**

Basic net income (loss) 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 (loss) per share reflects the potential dilution that would occur if outstanding securities or other contracts to issue common stock were exercised or converted into common stock.

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

	Three months ended	
	March 28, 2014	March 29, 2013
Numerator:		
Net income (loss)	\$ 7,056	\$ (311)
Denominator:		
Shares used in computation - basic:		

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Weighted average common shares outstanding	28,877	27,978
Shares used in computation diluted:		
Weighted average common shares outstanding	28,877	27,978
Dilutive effect of common shares outstanding subject to repurchase	664	
Dilutive effect of options outstanding	377	
Shares used in computing diluted net income (loss) per share	29,918	27,978
Net income (loss) per share basic	\$ 0.24	\$ (0.01)
Net income (loss) per share diluted	\$ 0.24	\$ (0.01)

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The Company had securities outstanding which could potentially dilute basic earnings per share in the future, but the incremental shares from the assumed exercise of these securities were excluded in the computation of diluted net income (loss) per share, as their effect would have been anti-dilutive. Such outstanding securities consisted of 288,237 stock options outstanding as of March 28, 2014 and 1,020,222 stock options outstanding as of March 29, 2013.

**7. Commitments and Contingencies**

The Company had commitments to purchase inventory totaling approximately \$40.5 million at March 28, 2014.

The Company leases properties domestically in Hayward, California; Austin, Texas, Pflugerville, Texas; Chandler, Arizona; and South San Francisco, California and internationally in China, Singapore and the Philippines. The Company leases certain of its facilities under non-cancelable leases, which expire on various dates through 2022.

As of March 28, 2014, future minimum payments under these operating leases were as follows (in thousands):

<b>Fiscal Year</b>	
2014 (remaining in year)	\$ 3,959
2015	4,635
2016	3,954
2017	3,370
2018	2,574
Thereafter	6,911
<b>Total minimum lease payments</b>	<b>\$ 25,403</b>

From time to time, the Company is subject to various legal proceedings and claims, either asserted or unasserted, that arise in the ordinary course of business. Although the outcome of the various legal proceedings and claims cannot be predicted with certainty, the Company has not had a history of outcomes to date that have been material to the statement of operations and does not believe that any of these proceedings or other claims will have a material adverse effect on its consolidated financial condition or results of operations.

**8. Segment Information**

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

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

	<b>Three months ended</b>	
	<b>March 28, 2014</b>	<b>March 29, 2013</b>
United States	\$ 105,805	\$ 83,213
China	17,541	4,752
Singapore	17,619	10,505
Other Asia	3,074	1,994
Europe	185	

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Total	\$ 144,224	\$ 100,464
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At March 28, 2014 and March 29, 2013, approximately \$3.7 million of the Company's net long-lived assets were located in Asia, and the remaining balances were located in the United States.

**Table of Contents****ITEM 2. Management's Discussion And Analysis of Financial Condition And Results Of Operations**

*You should read the following discussion of our financial condition and results of operations in conjunction with the condensed consolidated financial statements and the notes thereto included elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K filed with the SEC on March 12, 2014. This Quarterly Report on Form 10-Q contains forward-looking statements that involve substantial risks and uncertainties. The statements contained in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, including, but not limited to, statements regarding our expectations, beliefs, intentions, strategies, future operations, future financial position, future revenue, projected expenses, gross margins and plans and objectives of management. In some cases, you can identify forward-looking statements by terms such as anticipate, believe, estimate, expect, intend, may, might, plan, project, will, would, should, could, can, predict, potential, continue, objective, or the negative of these terms, and similar expressions intended to identify forward-looking statements. However, not all forward-looking statements contain these identifying words. These forward-looking statements reflect our current views about future events and involve known risks, uncertainties and other factors that may cause our actual results, performance or achievement to be materially different from those expressed or implied by the forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled Risk Factors included in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K filed with the SEC on March 12, 2014. Furthermore, such forward-looking statements speak only as of the date of this report. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances after the date of such statements.*

**Overview**

Ultra Clean Holdings, Inc. (Ultra Clean) was founded in November 2002 for the purpose of acquiring Ultra Clean Technology Systems and Service Inc. Ultra Clean Technology Systems and Service, Inc. was founded in 1991 by Mitsubishi Corporation and was operated as a subsidiary of Mitsubishi until November 2002, when it was acquired by Ultra Clean. Ultra Clean became a publicly traded company in March 2004. In June 2006, we completed the acquisition of Sieger Engineering, Inc. to better enhance our position as a subsystem supplier to the semiconductor, industrial, research, flat panel, energy and medical equipment industries. Ultra Clean Technology (Shanghai) Co., Ltd and Ultra Clean Micro-Electronics Equipment (Shanghai) Co., Ltd. were established in 2005 and 2007, respectively, to facilitate our operations in China. Ultra Clean Asia Pacific, Pte, Ltd. (Singapore), was established in fiscal year 2008 to facilitate our operations in Singapore. In July 2012, we acquired American Integration Technologies LLC (AIT) to immediately add to our customer base in the semiconductor and medical spaces and to provide additional manufacturing capabilities. We operate in one reportable segment.

We are a leading developer and supplier of critical subsystems, for Original Equipment Manufacturers (OEMs) primarily in the semiconductor capital equipment industry. We also leverage the specialized skill sets required to support semiconductor equipment to serve the technologically similar markets in the flat panel, medical, energy and research industries collectively referred to as Other Addressed Industries. We develop, design, prototype, engineer, manufacture and test systems and subsystems which are highly specialized and integral to our customers products.

We provide our customers with complete solutions that combine our expertise in design, test, component characterization and highly flexible global manufacturing operations with excellence in quality control and financial stability. Our global presence and supply chain management 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 provide global solutions for our customers' growing product demands.

We have shipped a majority of our products to U.S. registered customers with locations both in the U.S. and outside the U.S. In addition to U.S. manufacturing, we manufacture products in our Asian facilities to support local and U.S. based customers. We conduct our operating activities primarily through our wholly owned subsidiaries, Ultra Clean Technology Systems and Service, Inc., AIT LLC, Ultra Clean Technology (Shanghai) Co., Ltd., Ultra Clean Micro-Electronics Equipment (Shanghai) Co., Ltd. and Ultra Clean Asia Pacific, Pte Ltd. (Singapore).

**Financial Highlights**

Sales for the three months ended March 28, 2014, were \$144.2 million, an increase of \$43.8 million, or 43.6%, from \$100.5 million in the comparable quarter of 2013. Gross profit for the three months ended March 28, 2014 increased \$9.5 million, to \$23.3 million, or 16.2% of sales, from \$13.8 million, or 13.8% of sales, for the three months ended March 29, 2013. Total operating expenses for the three months ended March 28, 2014, were \$14.2 million, or 9.8% of sales, compared to \$13.2 million, or 13.1% of sales, for the three months ended March 29, 2013. For the three months ended March 28, 2014, we had net income of \$7.1 million, compared to net loss of \$0.3 million for the three months ended March 29, 2013.

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We had significant sales to three customers which accounted for 10% or more of sales for the three months ended March 28, 2014. For a further discussion, see Note 1. Organization and Significant Accounting Policies-*Significant Sales to Customers* in Notes to Condensed Consolidated Financial Statements above.

**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	
	March 28, 2014	March 29, 2013
Sales	100.0%	100.0%
Cost of goods sold	83.8%	86.2%
<b>Gross profit</b>	<b>16.2%</b>	<b>13.8%</b>
Operating expenses:		
Research and development	1.2%	1.3%
Sales and marketing	1.8%	2.3%
General and administrative	6.8%	9.6%
Total operating expenses	9.8%	13.2%
<b>Income from operations</b>	<b>6.4%</b>	<b>0.6%</b>
Interest and other (expense), net	(0.5)%	(1.0)%
<b>Income (loss) before provision (benefit) for income taxes</b>	<b>5.9%</b>	<b>(0.4)%</b>
Income tax provision (benefit)	1.0%	(0.0)%
<b>Net income (loss)</b>	<b>4.9%</b>	<b>(0.4)%</b>

**Sales**

Sales for the three months ended March 28, 2014, were \$144.2 million, an increase of \$43.8 million, or 43.6%, from \$100.5 million in the comparable quarter of 2013. Sales increased during the three months ended March 28, 2014 when compared to the same period of 2013 due to an increase in semiconductor sales of \$37.2 million and an increase in non-semiconductor sales of \$6.5 million. The increase in semiconductor sales for the three months ended March 28, 2014 as compared to the same period of 2013 was due primarily to an increase in the volume of products shipped, which is attributable to some recovery in customer demand from 2013 levels. The increase in non-semiconductor sales for the three months ended March 28, 2014 as compared to the same period of 2013 was due primarily to the addition of a new customer. On a geographic basis, sales in the U.S. increased by \$28.4 million to \$107.4 million, or 74.5% of sales, for the three months ended March 28, 2014 as compared to \$78.9 million, or 78.5% of sales for the same period of 2013. Non-U.S. sales increased by \$15.3 million to \$36.9 million, or 25.6% of sales, for the three months ended March 28, 2014 as compared to \$21.5 million, or 21.4% of sales, for the same period of 2013. The shift in sales from the U.S. to non-U.S. geographies is primarily attributable to increased manufacturing in Asia due to the transfer of existing products to our Asian facilities as a result of increased customer demand and new customer opportunities in China and Singapore. We expect sales to decrease modestly in the second quarter of fiscal 2014 as compared to the same period in 2013 due primarily to an anticipated downturn in customer demand in the semiconductor industry.

**Gross Profit**

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Cost of goods sold consists primarily of purchased materials, labor and overhead, including depreciation related to certain capital assets associated with the design and manufacture of products sold. Gross profit for the three months ended March 28, 2014 increased \$9.5 million, to \$23.3 million, or 16.2% of sales, from \$13.8 million, or 13.8% of sales, for the three months ended March 29, 2013. Gross profit for the three months ended March 28, 2014, when compared to the same period in fiscal 2013, increased primarily due to higher sales volume, a sales mix which included higher margin products and certain improvements in operational efficiencies at our manufacturing locations in the U.S., which typically deliver lower margins due to higher labor and overhead costs. We expect gross profit to be lower in the second quarter of 2014, when compared to the same period of fiscal 2014, primarily due to anticipated lower sales in the second quarter of 2014.

### *Research and Development Expense*

Research and development expense consists primarily of activities related to new component testing and evaluation, test equipment and fixture development, product design, and other product development activities. Research and development expense for the three months ended March 28, 2014, increased \$0.5 million, or 40.6%, to \$1.8 million, or 1.2% of sales, compared to \$1.3 million, or 1.3% of sales in the comparable period in 2013 due to the timing of reassignment of existing resources to research and development activities.

### *Sales and Marketing Expense*

Sales and marketing expense consists primarily of salaries and commissions paid to our sales and service employees, salaries paid to our engineers who work with the sales and service employees to help determine the components and configuration



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requirements for new products and other costs related to the sales of our products. Sales and marketing expense for the three months ended March 28, 2014 increased \$0.3 million, or 14.7%, to \$2.7 million, or 1.8% of sales, compared to \$2.3 million, or 2.3% of sales, in the comparable period of 2013. The increase in sales and marketing expense is primarily due to higher salaries and commissions as a result of an increase in headcount and revenues, respectively.

### *General and Administrative Expense*

Our general and administrative expense has historically consisted primarily of salaries and overhead associated with our administrative staff and professional fees. General and administrative expense increased approximately \$0.1 million, or 1.0% for the three months ended March 28, 2014, to \$9.7 million, or 6.7% of sales, compared with \$9.6 million, or 9.6% of sales, in the comparable period of 2013. The increase in absolute dollars when comparing the three months ended March 28, 2014 with the comparable period in 2013 is primarily due to an increase in headcount related costs offset by a decrease in the amortization of finite-lived intangibles associated with the AIT acquisition.

### *Interest and Other Income (Expense), net*

Interest and other income (expense), net, for the three months ended March 28, 2014, was \$0.6 million compared to \$1.0 million in the comparable period of 2013, primarily due to the decrease in interest expense as a result of the decrease in debt over the twelve months since March 29, 2013.

### *Income Tax Provision*

Our tax expense (benefit) and effective tax rate for the three months ended March 28, 2014 and March 29, 2013 was \$1.5 million and 17.3%, and (\$25,000) and (7.4)%, respectively. The change in respective rates reflects, primarily, a change in the geographic distribution of our world-wide earnings in foreign jurisdictions with lower tax rates or tax holidays as well as certain discrete tax items in the first quarter of 2014 our which increased our tax expense when compared to the same period in 2013.

In the three months ended March 28, 2014, we determined that a portion of the current year earnings of one of our China subsidiaries will be remitted in the future to one of our foreign subsidiaries outside of Mainland China and, accordingly, we provided for the related foreign withholding taxes in our condensed consolidated financial statements. Accordingly, no provision for U.S. taxes has been provided with respect to these unremitted earnings. If we change our intent to reinvest our undistributed foreign earnings indefinitely or if a greater amount of undistributed earnings are needed than the previously anticipated remaining unremitted foreign earnings, we could be required to accrue or pay U.S. taxes on some or all of these undistributed earnings.

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**Table of Contents*****Liquidity and Capital Resources***

We have required capital principally to fund our acquisitions and working capital needs, satisfy our debt obligations, maintain our equipment and purchase new capital equipment. As of March 28, 2014, we had cash of \$74.3 million compared to \$60.4 million as of December 27, 2013. Our cash and cash equivalents, as well as cash generated from operations, was our principal source of liquidity as of March 28, 2014.

For the three months ended March 28, 2014, we generated cash from operating activities of \$4.0 million compared to \$16.3 million for the comparable period of 2013. Operating cash flows generated in the three months ended March 28, 2014, included \$1.7 million of non-cash activity comprised of depreciation, amortization of intangibles, stock compensation expense, excess tax benefit from stock compensation and debt issuance costs. Other operating activities included increases in accounts receivable of \$4.7 million, inventory of \$3.5 million and increases in other liabilities of \$2.1 million and accounts payable of \$1.5 million. These increases were offset by a decrease in accrued compensation and related benefits of \$0.2 million. Our cash flows from operations in any given period are largely driven by the timing of sales, the collection of accounts receivable and the payment of accounts payable.

Net cash used in investing activities for the three months ended March 28, 2014, was \$0.5 million for capital expenditures. These investments are driven by the timing of our capital expenditures budget.

Net cash provided by financing activities for the three months ended March 28, 2014, was \$10.3 million compared to net cash used \$5.4 million for the comparable period of 2013. For the three months ended March 28, 2014, our net cash provided in financing activities was due primarily to additional borrowings of \$11.0 million on our revolver, offset by payments of \$2.5 million on the term loan under our current credit facility. In addition, we received proceeds of \$1.7 million related to the issuance of common stock, our increase of \$1.4 million associated with the excess tax benefit from stock based compensation, offset by payments of \$1.3 million associated with employees' taxes paid upon vesting of restricted stock units.

We anticipate that our existing cash balance and operating cash flow will be sufficient to service our indebtedness and meet our working capital requirements and technology development projects for at least the next twelve months. The adequacy of these resources to meet our liquidity needs beyond that period will depend on our growth, the state of the worldwide economy, our ability to meet our financial covenants with our credit facility, the cyclical expansion or contraction of the semiconductor capital equipment industry and the other industries we serve and capital expenditures required to meet possible increased demand for our products.

In order to expand our business or acquire additional complementary businesses or technologies, we may need to raise additional funds through equity or debt financings. If required, additional financing may not be available on terms that are favorable to us, if at all. If we raise additional funds through the issuance of equity or convertible debt securities, our stockholders' equity interest will be diluted and these securities might have rights, preferences and privileges senior to those of our current stockholders. We may also require the consent of our senior lenders to raise additional funds through equity or debt financings. No assurance can be given that additional financing will be available or that, if available, such financing can be obtained on terms favorable to our stockholders and us.

***Borrowing Arrangements***

On July 3, 2012, in connection with our acquisition of AIT and the refinancing of our prior credit facility, we entered into a credit agreement (the "Credit Agreement") by and among us, certain of our subsidiaries, Silicon Valley Bank, U.S. Bank National Association and HSBC Bank (collectively, the "Lenders"). The Credit Agreement provides for a term loan in an aggregate principal amount of \$40.0 million (the "Term Loan") and a revolving credit facility in an aggregate principal amount of \$40.0 million (the "Revolving Credit Facility"), a letter of credit facility in the aggregate availability amount of \$15.0 million (as a sublimit of such Revolving Credit Facility) (the "L/C Facility") and a swing line sub-facility in the aggregate availability amount of \$4.0 million (as a sublimit of the Revolving Credit Facility) (together with the Term Loan, the Revolving Credit Facility and the L/C Facility, the "Credit Facility"). On July 3, 2012, we borrowed an aggregate of \$40.0 million under the Term Loan and approximately \$39.8 million under the Revolving Credit Facility. The borrowed funds were used at the closing of our acquisition of AIT to finance the acquisition and repay the outstanding balance of \$3.7 million to Silicon Valley Bank as lender under our prior credit facility. The prior credit facility was terminated in connection with this transaction.

The Credit Facility must be repaid in consecutive quarterly installments of \$2.5 million, with the first payment made on September 30, 2012, and with the balance of the then-outstanding principal amount due at the final maturity, which is July 3, 2016. The Revolving Credit Facility is available for the four-year period beginning on July 3, 2012. The Credit Agreement includes customary representations, warranties, covenants and events of default. We and certain of our subsidiaries have agreed to secure all of our obligations under the Credit Agreement by granting a first priority lien in substantially all of our respective personal property assets of these entities (subject to certain exceptions and limitations).



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At our option, borrowings under the Term Loan and Revolving Credit Facility (subject to certain limitations) bear interest at either a base rate or at the London Interbank Offered Rate ( LIBOR ) (with the LIBOR being adjusted for certain Eurocurrency reserve requirements, if any, as described in the Credit Agreement), plus, in each case, an applicable margin based on our consolidated leverage ratio. All loans described above made on July 3, 2012 were initially base rate loans, carrying interest of 3.75%. As of March 28, 2014, the interest rates on the Term loan and Revolving Credit Facility were 3.67% and 3.75%, respectively. The effective interest rates will be slightly higher due to the incurrence of certain loan-related costs of approximately \$1.9 million that are treated as deferred interest and amortized over the life of the loan.

The Credit Agreement requires us to maintain certain financial covenants including a minimum consolidated fixed charge coverage ratio, a maximum consolidated leverage ratio and minimum domestic cash balances. On February 15, 2013, we and the Lenders amended the Credit Agreement in order to modify the financial covenants contained in the Credit Agreement, effective January 30, 2013. The Credit Agreement, as amended, requires us to comply with the following financial covenants:

a minimum consolidated fixed charge coverage ratio (as defined in the Credit Agreement, as amended), measured over the preceding four fiscal quarters, beginning as of the end of the third quarter of fiscal 2014, of 1.10 to 1.00, stepping up to 1.25 to 1.00 as of the end of each fiscal quarter beginning with the first quarter of fiscal 2015 and thereafter;

a maximum consolidated leverage ratio (as defined in the Credit Agreement, as amended) measured over the preceding four fiscal quarters, beginning, as of the end of the third quarter of fiscal 2014, of 4.00 to 1.00, stepping down to 3.75 to 1.00 as of the end of the fourth quarter of fiscal 2014 and thereafter to and including the third quarter of 2015, and 3.25 to 1.00 as of the end of each fiscal quarter beginning with the fourth quarter of 2015 and thereafter;

minimum domestic cash of \$15.0 million as of the last day of any fiscal quarter and \$10.0 million as of the last day of any other fiscal month from January 25, 2013 and thereafter;

a minimum consolidated quick ratio (as defined in the Credit Agreement, as amended) of 1.10 to 1.00 as of the end of each fiscal month from January 25, 2013 and thereafter;

minimum consolidated adjusted EBITDA (as defined in the Credit Agreement, as amended), measured over the preceding two quarters, of \$6.0 million as of the end of the fourth quarter of 2013, \$7.0 million as of the end of the first quarter of 2014 and \$8.0 million as of the end of the second quarter of 2014 and each quarter thereafter.

We were in compliance with all covenants for the quarter ended March 28, 2014.

The Credit Agreement contains provisions requiring the following mandatory prepayments (subject to certain exceptions and limitations): (i) prepayments equal to 50% of the net cash proceeds from the issuance of capital stock by our primary operating subsidiary (or any of its subsidiaries); (ii) prepayments equal to 100% of the net cash proceeds from the incurrence of any indebtedness by our primary operating subsidiary over \$250,000; (iii) prepayments equal to the net cash proceeds from certain asset sales or insurance or condemnation recoveries; and (iv) annual prepayments in an amount equal to (a) 33% of excess cash flow (as defined in the Credit Agreement, as amended) if the aggregate outstanding principal amount of the Term Loan equals or exceeds \$20.0 million and (b) 25% of excess cash flow if the aggregate outstanding principal amount of the Term Loan equals or exceeds \$10.0 million but is less than \$20.0 million.

The Credit Agreement also restricts us from declaring or paying any cash dividends.

As of March 28, 2014, the outstanding amounts under our Term Loan and Revolving Credit Facility were \$25.0 million and \$39.8 million, respectively, which are net of unamortized debt issuance costs of \$1.1 million for a total debt balance of \$63.7 million. We analyzed the Credit Agreement and determined that the outstanding balance of Revolving Credit Facility debt should be classified as short-term due to acceleration clauses in the agreement.

***Capital Expenditures***

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Capital expenditures were \$0.5 million in the three months ended March 28, 2014. The Company's anticipated capital expenditures for the remainder of 2014 are anticipated to be financed through cash from operations.

### *Off-Balance Sheet Arrangements*

During the periods presented, we did not have any relations with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes.

**Table of Contents****Contractual Obligations**

Other than operating leases for certain equipment and real estate and purchase order commitments primarily for inventory, we have no off-balance sheet transactions, unconditional purchase obligations or similar instruments and, other than the arrangements described under Borrowing Arrangements above, are not a guarantor of any other entities' debt or other financial obligations. The following table summarizes our future minimum lease payments, principal payments under debt obligations and our purchase obligations for the purchase of inventory as of March 28, 2014 (in thousands):

	Remainder of 2014	2015	2016	2017	2018	Thereafter	Total
Operating leases (1)	\$ 3,959	\$ 4,635	\$ 3,954	\$ 3,370	\$ 2,574	\$ 6,911	\$ 25,403
Borrowing Arrangement (2)	47,344	10,000	7,500				64,844
Purchase order commitments	40,526						40,526
Total	\$ 91,829	\$ 14,635	\$ 11,454	\$ 3,370	\$ 2,574	\$ 6,911	\$ 130,773

- Operating lease obligations reflects (a) the lease for our headquarters facility in Hayward, California that expires in 2022; (b) the leases for manufacturing facilities in South San Francisco that expire in 2018; (c) the leases for manufacturing facilities in China, Singapore and the Philippines that expire in 2014 thru 2016; (d) the leases for manufacturing facilities in Austin, Texas that expire in 2016; (e) the leases for manufacturing facilities in Chandler, Arizona that expire in 2015 through 2017; and (f) the leases for manufacturing facilities in Pflugerville, Texas that expire in 2018. We have options to renew certain of the leases in South San Francisco, Hayward and Austin which we expect to exercise.
- Amounts reflect obligations under our Credit Facility net of \$1.1 million of unamortized debt issuance costs, under which \$25.0 million is outstanding under the Term Loan and approximately \$39.8 million is outstanding under the Revolving Credit Facility as of March 28, 2014. The Term Loan must be repaid in consecutive quarterly installments of \$2.5 million and with the balance of the outstanding principal amount of the Term Loan due at the final maturity, which is July 3, 2016. The Revolving Credit Facility is available for the four-year period beginning on July 3, 2012; however, we analyzed the Credit Agreement and determined that the outstanding balance of the Revolving Credit Facility should be classified as short-term due to the acceleration clauses in the agreement. Accordingly, all amounts due under the Revolving Credit Facility are reflected in the 2014 column. See Note 4. Borrowing Arrangements in Notes to Consolidated Financial Statements below.

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

Our consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States, which require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses and related disclosure at the date of our consolidated financial statements. On an on-going basis, we evaluate our estimates and judgments, including those related to sales, inventories, goodwill and intangible assets, stock compensation and income taxes. We base our estimates and judgments 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 our 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 revenue recognition, inventory valuation, accounting for income taxes, business combinations, valuation of intangible assets and goodwill, and equity incentives to employees to be critical policies due to the estimates and judgments involved in each.

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

We are exposed to financial market risks, including changes in currency exchange rates and interest rates.

**Foreign Exchange Rates**

Currently, a significant majority of our sales and arrangements with third-party suppliers provide for pricing and payment in US dollars, and, therefore, are not subject to material exchange rate fluctuations. Therefore, we do not expect foreign currency exchange rate fluctuations to have

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a material effect on our results of operations. However, increases in the value of the U.S. dollar relative to other currencies would make our products more expensive relative to competing products priced in such other currencies, which could negatively impact our ability to compete. Conversely, decreases in the value of the U.S. dollar relative to other currencies could result in our foreign suppliers raising their prices in order to continue doing business with us.

Chinese authorities have relaxed controls of China's currency, the Renminbi, over the past couple of years and allowed the currency to strengthen against other world currencies, including the U.S. dollar. We continue to monitor any potential impact of the appreciation of the Renminbi on our operations in China as well as globally. Changes in the value of the Renminbi did not have a material impact on our results of operations for any period presented in this Form 10-Q.

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***Interest Rates***

Our interest rate risk relates primarily to our debt which totals \$63.7 million, net of debt issuance costs of \$1.1 million, as of March 28, 2014, and carries interest rates pegged to either the prime rate or LIBOR. An immediate increase in interest rates of 100 basis points would increase our interest expense by approximately \$0.2 million per quarter. This would be partially offset by increased interest income on our invested cash. Conversely, an immediate decline of 100 basis points in interest rates would decrease our interest expense by approximately \$0.2 million per quarter. This would be partially offset by decreased interest income on our invested cash.

**ITEM 4. Controls and Procedures**

As required by Rule 13a-15(b) under the Securities Exchange Act of 1934 (the Exchange Act ), management, including our Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this report, of the effectiveness of our disclosure controls and procedures as defined in Exchange Act Rule 13a-15(e). Based upon our evaluation, we concluded that our disclosure controls and procedures were effective as of March 28, 2014.

As required by Rule 13a-15(d), management, including our Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of our internal control over financial reporting to determine whether any changes occurred during the period covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. Based on our evaluation, we concluded that there has been no change during the fiscal quarter covered by this report that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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



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**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

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. Although the outcome of the various legal proceedings and claims cannot be predicted with certainty, we have not had a history of outcomes to date that have been material to our statement of operations and do not believe that any of these proceedings or other claims will have a material effect on our consolidated financial condition or results of operations.

**ITEM 1A. Risk Factors**

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

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

*We rely on a small number of original equipment manufacturing (OEM) customers for a significant portion of our sales, and any adverse change in our relationships with these customers, including a decision by such customers not to continue to outsource critical subsystems or to give market share to one of our competitors, would adversely affect our business, results of operation and financial condition. Our customers also exert a significant amount of negotiating leverage over us, which may require us to accept lower operating margins or increased liability risk in order to retain or expand our market share with them.*

A relatively small number of OEM customers have historically accounted for a significant portion of our sales, and we expect this trend to continue. As a group, significant customers comprising 10% or greater of our sales accounted for 79.0% of our sales for the three months ended March 28, 2014, and we expect that our sales will continue to be concentrated among a small number of customers. In addition, our customer contracts generally do not require customers to place any orders. Accordingly, the success of our business depends on OEMs continuing to outsource the manufacturing of critical subsystems to us. Because of the small number of OEMs in the markets we serve, most of which are already our customers, it would be difficult to replace lost revenue resulting from the loss of, or the reduction, cancellation or delay in purchase orders by, any one of these customers, whether due to their decision to not continue to outsource all or a portion of their critical subsystems for their capital equipment, their giving market share to our competitors or otherwise. We have in the past lost business from customers who have taken the manufacturing of our products in-house or given market share to our competitors. For example, we terminated our manufacturing services to FEI Company at the beginning of our second quarter of fiscal 2012. In addition, we announced in the third quarter of fiscal 2012 that one of our larger semiconductor equipment customers had decided to in-source a portion of their gas panel business. If we are unable to replace revenue from customers who determine to take subsystem assembly in-house or give market share to our competitors, such events could have a material adverse impact on our financial position and results of operation.

In addition, consolidation among our customers, or a decision by any one or more of our customers to outsource all or most manufacturing and assembly work to a single equipment manufacturer, may further concentrate our business in a limited number of customers and expose us to increased risks relating to dependence on an even smaller number of customers. For example, two of our largest semiconductor customers, Novellus Systems, Inc. and Lam Research Corporation, announced in June 2012 that they had completed a transaction pursuant to which they consolidated their businesses. Also, in November 2011, Applied Materials, Inc. completed the acquisition of Varian Semiconductor Equipment Associates, Inc., one of our customers.

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In addition, if we are unable to obtain additional business from OEMs on favorable terms, or at all, even if they continue to outsource their production of critical subsystems, the potential growth of our business could be adversely affected. By virtue of our largest customers' size and the significant portion of revenue that we derive from them, as well as the competitive landscape, our customers are able to exert significant influence and pricing pressure in the negotiation of our commercial agreements and the conduct of our business with them. Our customers often require reduced prices or other pricing, quality or delivery commitments as a condition to their awarding of market share to us in any given period, which may, among other things, result in reduced operating margins in order to maintain or expand our market share. Our customers' negotiating leverage also can result in customer agreements that may contain significant liability risk to us. For example, some of our customers insist that we provide them indemnification against certain liabilities in our agreements with them, including claims of losses by their customers caused by our products. If we are unable to retain

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and expand our business with our customers on favorable terms, or at all, our business and operating results will be adversely affected, or we may be susceptible to increased liability risk which, if realized, may have a material adverse effect on our business, cash flows, results of operation and financial condition. In some cases, we have determined to self-insure against liability risk in our customer agreements, meaning that we may be directly responsible for high magnitude liability claims by our customers without recourse to insurance proceeds from third-party insurers.

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 limited because of these qualification requirements. Consequently, the risk that 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 is increased. Moreover, if we lost our existing status as a qualified supplier to any of our customers, such customer could cancel its orders from us or otherwise terminate its relationship with us, which could have a material adverse effect on our results of operation and financial condition.

### ***We are exposed to risks associated with weakness in the global economy.***

We rely to a significant extent on OEM customers, whose business, in turn, depends largely on consumer spending and capital expenditures by businesses. Continuing uncertainty regarding the global economy continue to pose challenges to our business. Economic uncertainty and related factors, including current unemployment levels, uncertainty in European debt markets, fiscal uncertainty in the U.S. economy, market volatility and the slow rate of recovery of many countries from recent recessions, exacerbate negative trends in business and consumer spending and may cause certain of our customers to push out, cancel, or refrain from placing orders for products or services, which may reduce sales and materially affect our results of operation and financial condition. Difficulties in obtaining capital, uncertain market conditions, or reduced profitability may also cause some customers to scale back operations, exit businesses, merge with other manufacturers, or file for bankruptcy protection and potentially cease operations, leading to customers' reduced research and development funding and/or capital expenditures and, in turn, lower orders from our customers and/or additional slow moving or obsolete inventory or bad debt expense for us. These conditions may also similarly affect key suppliers, which could impair their ability to deliver parts and result in delays for our products or require us to either procure products from high-cost suppliers, or if no additional suppliers exist, to reconfigure the design and manufacture of our products, and we may be unable to fulfill some customer orders.

### ***We have significant existing indebtedness; the restrictive covenants under our credit agreement or other limitations on financing may limit our ability to expand or pursue our business strategy or make capital expenditures; if we are forced to pay some or all of our indebtedness prior to its maturity, our financial position could be severely and adversely affected.***

We have significant outstanding indebtedness. On July 3, 2012, we refinanced our prior credit facility and entered into our current credit agreement with Silicon Valley Bank, U.S. Bank National Association and HSBC Bank. The current credit agreement provides for a term loan in an aggregate principal amount of \$40.0 million and a revolving credit facility in an aggregate principal amount of \$40.0 million. On July 3, 2012, we borrowed \$40.0 million under the term loan and \$39.8 million under the revolving credit facility to finance our acquisition of AIT and repay Silicon Valley Bank as lender under our prior credit facility. As of March 28, 2014, the long-term portion of our outstanding indebtedness, net of debt issuance costs, under our credit facility was \$14.9 million, and the short-term portion was \$48.8 million.

Our credit agreement contains certain covenants that restrict our ability to take certain actions, including our ability to:

incur additional debt, including guarantees, or create liens;

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

repurchase capital stock;

make investments or other restricted payments;

engage in transactions with stockholders and affiliates;

sell or otherwise dispose of assets;

make payments on subordinated indebtedness; and

engage in certain mergers and acquisitions, new lines of business or make other fundamental changes.

The restrictive covenants in our credit agreement may therefore limit our strategic and financing options and our ability to return capital to our stockholders through dividends or stock buybacks.

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Our credit agreement also requires us to maintain certain financial and other covenants. We cannot assure you that we will be able to maintain compliance with such financial or other covenants. For example, for the measurement periods ending in November and December of 2012, we were not in compliance with the minimum consolidated fixed charge coverage ratio, the maximum consolidated leverage ratio or the minimum domestic cash balance covenants under the credit agreement. On February 15, 2013, the Company and its lenders amended the credit agreement in order for the lenders to waive such non-compliance and to modify the financial covenants contained in the credit agreement, effective January 30, 2013. We cannot assure you, however, that we will be able to meet the financial or other covenants under our amended credit agreement in subsequent periods. Our failure to comply with these covenants could result in an event of default which, if not cured or waived, could result in the acceleration of all of our indebtedness, which would materially adversely affect our financial health if we are unable to access sufficient funds to repay all the outstanding amounts. Moreover, if we are unable to meet our debt obligations as they come due, we could be forced to restructure or refinance such obligations, seek additional equity financing or sell assets, which we may not be able to do on satisfactory terms, or at all.

In addition, the credit agreement has certain mandatory prepayment provisions, including annual prepayments of excess cash flow above certain thresholds. As long as our indebtedness remains outstanding, the restrictive covenants and mandatory prepayment provisions could impair our ability to expand or pursue our business strategies or obtain additional funding.

### ***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 suppliers could adversely affect our business and operating results. In addition, the manufacturing of certain components and subsystems is a complex process. Therefore, if a supplier were unable to provide the volume of components we require on a timely basis and at acceptable prices and quality, we would have to identify and qualify replacements from alternative sources of supply. However, the process of qualifying new suppliers for complex components is also 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.

If we, or our vendors, are unable to procure sufficient quantities of components or raw materials from suppliers, it could influence decisions by our customers to delay or cancel orders and decisions by our vendors to fulfill our purchase orders and, consequently, have a material adverse effect on our results of operations.

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

Demand shifts in the industries we serve are rapid and difficult to predict, and we may not be able to anticipate or respond quickly enough to changes in demand. Our ability to increase sales of our products in periods of increasing demand 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

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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.

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Our ability to remain profitable and mitigate the impact on our business in periods of decreasing demand depends, in part, upon our ability to:

optimize our inventory levels and reduce or cancel orders to our suppliers without compromising our relationships with such suppliers;

reduce our variable costs, including through a reduction of our manufacturing workforce;

continue to motivate our employees; and

maintain the prices, quality and delivery cycles of our products in order to retain our customers' business.

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

We made capital expenditures of approximately \$0.5 million during the three months ended March 28, 2014 and \$3.0 million in fiscal 2013 related to our manufacturing facilities in the United States, China and Singapore. In addition, we paid approximately \$75.3 million in cash and issued 4.5 million shares of our common stock valued at \$29.6 million for a total purchase price of \$104.9 million in connection with our acquisition of AIT. The cash portion of the merger consideration was financed through the credit facility described above. The amount of our future capital requirements or strategic acquisitions 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;

the cost required to complete AIT's enterprise resource planning implementation and to migrate AIT and its subsidiaries to our enterprise resource planning system;

changing manufacturing capabilities to meet new customer requirements;

market acceptance of our products; and

our ability to identify appropriate acquisition opportunities and successfully negotiate the terms of such acquisitions.

We had \$74.3 million in cash and cash equivalents and no borrowings available under our Revolving Credit Facility as of March 28, 2014. In addition, as of March 28, 2014, \$52.9 million of our cash and cash equivalents was held by our foreign subsidiaries. If these funds are needed for our operations or to fund capital expenditures or other strategic acquisitions in the U.S., we would be required to accrue and pay U.S. taxes to repatriate these funds.

Given our significant existing leverage, lack of additional availability under our current revolving line of credit and the potential tax effects of repatriating foreign cash, we may need to raise additional funds through public or private equity or debt financing if our current domestic cash

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and cash flow from operations are insufficient to fund our future activities. We may not be able to obtain additional debt financing when and if necessary in a timely manner. Access to capital markets has, in the past, been unavailable to companies such as ours and there can be no assurance that we would be able to complete an equity or other financing with terms satisfactory to us or at all. In addition, equity financings could be dilutive to holders of our common stock, and debt financings would likely involve additional covenants that restrict our business operations. Any potential strategic acquisition or significant capital expenditure may also require the consent of our existing lenders. 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, including potential acquisitions, grow our business or respond to competitive pressures or unanticipated requirements, any of which could adversely affect our business, operating results and financial condition.

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

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



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demand for and market acceptance of our products as a result of the cyclical nature of the industries we serve or otherwise, often resulting in reduced sales during industry downturns and increased sales during periods of industry recovery or growth;

overall economic conditions;

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

strategic decisions by our customers to terminate their outsourcing relationship with us or give market share to our competitors;

strategic consolidation 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 or loss of market share;

disruptions or delays in the manufacturing of our products or in the supply of components or raw materials that are incorporated into or used to manufacture our products, thereby causing us to delay the shipment of products;

decreased margins for several or more quarters following the introduction of new products, especially as we introduce new subsystems;

delays in ramp-up in production, low yields or other problems experienced at our manufacturing facilities in China;

changes in design-to-delivery cycle times;

inability to reduce our costs quickly in step with reductions in our prices or in response to decreased demand for our products;

changes in our mix of products sold;

write-offs of excess or obsolete inventory;

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

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

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geographic mix of customer orders or 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 our guidance or the expectations of securities analysts or investors. If this occurs, we would expect to experience an immediate and significant decline in the trading price of our common stock.

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

We generated approximately 25.6% and 28.5% of our sales in international markets for the three months ended March 28, 2014 and fiscal 2013, respectively. Depending on market conditions, we intend to expand our operations in Asia, principally in China and Singapore. In addition, through our acquisition of AIT, we acquired a manufacturing facility in Cebu, Philippines. The gross carrying amount of our fixed assets in Asia was \$14.1 million as of March 28, 2014.

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

foreign currency exchange fluctuations;

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political, civil and economic instability;

tariffs and other barriers;

timing and availability of export licenses;

disruptions to our and our customers' operations due to increased risk of outbreak of diseases, such as SARS and avian flu;

disruptions in operations due to China's developing 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 distant international subsidiary and branch operations;

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

legal systems potentially subject to undue influence or corruption;

difficulty in transferring funds to other geographic locations; and

potentially adverse tax consequences, including restrictions on the repatriation of earnings to the United States.

In addition, due to generally lower labor and materials costs in the Asian markets in which we currently operate, a shift in the mix of orders from our customers away from such Asian markets could adversely affect our operating margins.

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

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

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

Our revenue is difficult to forecast because we generally do not have a material backlog of unfilled orders and because of the short time frame within which we are often required to design, produce and deliver products to our customers. Most of our revenue in any quarter depends on customer orders for our products that we receive and fulfill in the same quarter. We do not have long-term purchase orders or contracts that contain minimum purchase commitments from our customers. Instead, we receive non-binding forecasts of the future volume of orders from our customers. Occasionally, we order and build component inventory in advance of the receipt of actual customer orders. Customers may cancel order forecasts, change production quantities from forecasted volumes or delay production for reasons beyond our control. Furthermore, reductions, cancellations or delays in customer order forecasts usually occur without penalty to, or compensation from, the customer. Reductions, cancellations or delays in forecasted orders could cause us to hold inventory longer than anticipated, which could reduce our gross profit, restrict our ability to fund our operations and cause us to incur unanticipated reductions or delays in revenue. If we do not obtain orders as we anticipate, we could have excess component inventory for a specific product that we would not be able to sell to another customer, likely resulting in inventory write-offs, which could have a material adverse effect on our business, financial condition and operating results. In addition, because many of our costs are fixed in the short term, we could experience deterioration in our gross profit and operating margins when our production volumes decline.

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

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

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

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

***The success of our merger with AIT will depend, among other things, on successfully maintaining or improving relationships with AIT's customers and motivating and retaining AIT's employees, and any failure to integrate successfully the businesses of Ultra Clean and AIT will adversely affect the combined company's future results.***

Our acquisition of AIT in the third quarter of fiscal 2012 was a significant acquisition to us and the largest acquisition in our history. The success of our merger with AIT will depend, in large part, on the ability of the combined company to realize the anticipated benefits of the transaction, including combined capabilities and resources, new customers and, to a lesser extent, annual net operating synergies. To realize these anticipated benefits, the combined company must successfully integrate the pre-existing businesses of Ultra Clean and AIT, which integration is on-going. Our efforts to fully integrate two companies that have previously operated independently may result in significant challenges, and we may be unable to accomplish the integration smoothly or successfully. The failure to integrate successfully and to manage successfully the challenges presented by the integration process may result in the combined company's failure to achieve some or all of the anticipated benefits of the merger. In particular, like us, AIT's pre-existing business was concentrated in a small number of customers who do not have long-term purchase orders or contracts that contain minimum purchase commitments. AIT's customers may react negatively to the combined business and reduce or cease doing business with the combined company in favor of our competitors or taking our business in-house. The failure to maintain important customer relationships could have a material adverse effect on the business, financial condition or results of operations of the combined company. The integration also requires combining personnel with varied business backgrounds and combining businesses with different corporate cultures and objectives. AIT has its own unique business culture and business processes that may be disrupted in the process of integrating the businesses of the combined company. These disruptions could result in employee dissatisfaction and attrition, operational inefficiencies or increased operating costs and have a material adverse impact on the combined company's results of operation and financial condition.

Other potential difficulties that may be encountered in the integration process include the following:

Complexities associated with managing the larger, more complex, combined business, including integrating supply and distribution channels, computer and accounting systems, and other aspects of operations;

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Ensuring AIT and the combined company are in compliance with public company obligations within required periods, including the corporate governance and other requirements of the Sarbanes-Oxley Act of 2002, to which AIT was not previously subject as a privately held company;

Integrating capabilities from the two companies while maintaining focus on providing consistent, high quality products;

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Incorporating different financial and reporting controls, processes, systems and technologies into our existing business environment;

Potential unknown liabilities and unforeseen expenses, delays or regulatory conditions associated with the merger for which we do not have recourse under the merger agreement; and

Performance shortfalls at one or both of the companies as a result of the diversion of management's attention caused by integrating the companies' operations.

We may incur substantial costs associated with these activities and we may suffer other material adverse effects from our integration efforts, including write-downs, impairment charges or unforeseen liabilities which could negatively affect our operating results or financial position or could otherwise harm our business. We cannot assure you that the combined company will be successful or will realize expected operating efficiencies, revenue and earnings accretion and other benefits currently anticipated to result from the merger. The dedication of management resources to such integration may also detract attention from the day-to-day business, and we may need to hire additional management personnel to manage our acquisitions successfully, resulting in increased operating costs.

***We may not be able to integrate efficiently the operations of other businesses acquired in the future, which would adversely affect the combined company's future results.***

We have made, and may in the future make, acquisitions of, or significant investments in, businesses that offer complementary products, services, technologies or market access. For example, we acquired Sieger Engineering, Inc. in June 2006 and AIT in July 2012. Management also evaluates other potential strategic transactions regularly with its advisors and our board of directors in the ordinary course of business. If we identify an appropriate acquisition candidate, we may not be successful in negotiating the terms of the acquisition, financing the acquisition, or effectively integrating the acquired business, product or technology into our existing business and operations. Our due diligence may fail to identify all of the problems, liabilities or other shortcomings or challenges of an acquired business, product or technology, including issues related to intellectual property, product quality or product architecture, regulatory compliance practices, revenue recognition or other accounting practices or employee or customer issues.

Additionally, in connection with any acquisitions we are able to complete, we would likely face challenges in integrating the acquired business that are similar to those we may face in integrating AIT's operations that are discussed in the preceding risk factor. These challenges may result in substantial costs, the failure to achieve expected synergies or other anticipated benefits and other effects which could adversely affect our results of operations in a material way. The dedication of management resources to such integration or divestitures may divert attention from our day-to-day business, and we may need to hire additional management personnel to manage our acquisitions successfully.

Moreover, our acquisition of AIT in fiscal year 2012 could compound the challenges of integrating complementary products, services and technologies in the future. As discussed above, our integration with AIT is not yet complete, and completing the integration could divert a significant amount of management resources, resulting in less employee time and resources available to focus on negotiating and integrating new acquisitions.

If we finance future acquisitions by issuing convertible debt or equity securities, our existing stockholders may be diluted, which could affect the market price of our stock. Even if an acquisition or other investment is not completed, we may incur significant management time and effort and financial cost in evaluating such acquisition or investment, which could have an adverse effect on our results of operations. Furthermore, due to limited liquidity in the credit market and our existing leverage, the financing of any such acquisition may be difficult to obtain, and the terms of such financing may not be favorable.

***If we were required to write down all or part of our goodwill, our net income and net worth could be materially adversely affected.***

We had \$55.9 million of goodwill recorded on our consolidated balance sheet as of March 28, 2014. Goodwill represents the excess of cost over the fair market value of net tangible and finite lived, identifiable intangible assets acquired in business combinations. If our market capitalization drops significantly below the amount of net equity recorded on our balance sheet, it could indicate a decline in our value and would require us to further evaluate whether our goodwill has been impaired. During the fourth quarter of each year, we perform an annual review of our goodwill to determine if it has become impaired, in which case we would write down the impaired portion of our goodwill. We also evaluate goodwill for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. If we were required to write down all or a significant part of our goodwill, our financial results and net worth could be materially adversely affected.





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

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 primarily 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 infringement or breach of our proprietary rights occurs, our competitive position in the market may be harmed. In addition, competitors may design around our technology or develop competing technologies and know-how.

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

We have in the past and may in the future receive claims that our products, processes or technologies infringe the patents or other proprietary rights of third parties. In addition, we may be unaware of intellectual property rights of others that may be applicable to our products. Any litigation regarding our patents or other intellectual property could be costly and time-consuming and divert our management and key personnel from our business operations, any of which could have a material adverse effect on our business and results of operations. The complexity of the technology involved in our products and the uncertainty of intellectual property litigation increase these risks. Claims of intellectual property infringement may also require us to enter into costly license agreements. However, we may not be able to obtain licenses on terms acceptable to us, or at all. We also may be subject to significant damages or injunctions against the development, manufacture and sale of certain of our products if any such claims prove successful. We also rely on design specifications and other intellectual property of our customers in the manufacture of products for such customers. While our customer agreements generally provide for indemnification of us by our customers if we are subjected to litigation for third-party claims of infringement of such customer intellectual property, such indemnification provisions may not be sufficient to fully protect us from such claims, or our customers may breach such indemnification obligations to us, which could result in costly litigation to defend against such claims or enforce our contractual rights to such indemnification.

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

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

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

design innovative and performance-enhancing features that differentiate our products from those of our competitors;

identify emerging technological trends in the industries we serve, including new standards for our products;

accurately identify and design new products to meet market needs;

collaborate with OEMs to design and develop products on a timely and cost-effective basis;

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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.

If we are unsuccessful in keeping pace with technological developments for the reasons above or other reasons, our business prospects, results of operations and financial condition could be materially and adversely affected.

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

We face intense competition from subsystem and component manufacturers in the industries we serve. 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 significant pricing pressure as we attempt to maintain and increase market share with our existing customers. Competitors may offer reduced prices or introduce new products for the markets currently served by our products. These products may have better performance, lower prices and achieve broader market acceptance than our products. Further, OEMs typically own the design rights to their products and may provide these designs to other subsystem manufacturers. If our competitors obtain proprietary rights to these designs such that we are unable to obtain the designs necessary to manufacture products for our OEM customers, our business, financial condition and operating results could be adversely affected.

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

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

New capital equipment typically has a lifespan of several years, and OEMs frequently specify which systems, subsystems, components and instruments are to be used in their equipment. Once a specific system, subsystem, component or instrument is incorporated into a piece of capital equipment, it will likely continue to be incorporated into that piece of equipment for at least several months before the OEM would be in a position to switch to the product of another supplier. Accordingly, it is important that our products are designed into the new capital equipment of OEMs, which we refer to as a design win, in order to retain our competitive position with existing customers and to obtain new customers.

We incur technology development and sales expenses with no assurance that our products will ultimately be designed into an OEM's capital equipment. Further, developing new customer relationships, as well as maintaining and 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 consider long-term relationships in selecting and placing orders with suppliers. 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.

***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;

result in liability for the unintended release of hazardous materials;

create claims for rework, replacement and/or damages under our contracts with customers, as well as indemnification claims from customers;

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.

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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 warranty and indemnification liability, the loss of existing customers or impair our ability to attract new customers. In addition, we may not find defects or failures in our products until after they are installed in a manufacturer's fabrication facility. We may have to invest significant capital and other resources to correct these problems. Our current or potential customers also might seek to recover from us any losses resulting from defects or failures in our products. Hazardous materials flow through and are controlled by our products and an unintended release of these materials could result in serious injury or death. Liability claims could require us to spend significant time and money in litigation or pay significant damages.

***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 limited number of engineers possess. The loss of any of our key employees and officers, including our Chief Executive Officer, our Chief Financial Officer, any of our Senior Vice Presidents or any of the senior managers of AIT, or the failure to attract and retain new qualified employees, could adversely affect our business, operating results and financial condition. Further, in March 2014, Gino Addigo, our President and Chief Operating Officer, resigned. If we are unable to transition Mr. Addigo's role and responsibilities to one or more qualified individuals, our business, financial results and financial position could be materially adversely affected.

The challenges of employee retention has also increased during the integration process with AIT because of the necessity of combining personnel with varied business backgrounds and combining different corporate cultures and objectives, and several AIT employees, including members of AIT's senior management, have left our company. The process of integrating operations and making such adjustments could cause an interruption of, or loss of momentum in, the activities of one or more of our businesses and the loss of key personnel. Employee uncertainty, lack of focus or turnover during the integration process may also disrupt our businesses.

***If we fail to maintain an effective system of internal controls, we might not be able to report our financial results accurately or prevent fraud; in that case, our stockholders could lose confidence in our financial reporting, which would harm our business and could negatively impact the price of our stock.***

Effective internal controls are necessary for us to provide reliable financial reports and prevent fraud. In addition, Section 404 of the Sarbanes-Oxley Act of 2002 requires us and our independent registered public accounting firm to evaluate and report on our internal control over financial reporting. The process of designing, implementing, maintaining and updating our internal controls and complying with Section 404 is expensive and time consuming, and requires significant attention from management and company resources. For example, beginning as of the fiscal year ended December 27, 2013, we and our independent registered public accounting firm were required to evaluate and report on AIT's internal controls. Integrating AIT's internal control framework into the Company and upgrading AIT's controls to comply with the Sarbanes-Oxley Act has required substantial resources, and we cannot assure you that we will be able to successfully or effectively maintain adequate controls over our financial processes at AIT or for our consolidated business. In addition, even though we have concluded, and our independent registered public accounting firm has concurred, that our internal control over financial reporting provides reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles as of December 27, 2013, because of its inherent limitations, internal control over financial reporting may not prevent or detect fraud or misstatements, and our internal control may not be effective as of future periods. Failure to maintain existing or implement new or improved controls, or difficulties encountered in their implementation, could harm our results of operations or cause us to fail to meet our reporting obligations. If we or our independent registered public accounting firm discover a material weakness, the disclosure of that fact, even if quickly remedied, could reduce the market's confidence in our financial statements and harm our stock price.

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

Our international sales are denominated primarily, though not entirely, in U.S. dollars. Many of the costs and expenses associated with our Chinese subsidiaries and Singapore subsidiary are paid in Chinese Renminbi and Singapore dollars, respectively, and we expect our exposure to Chinese Renminbi and Singapore dollars to increase as we increase production in those facilities. In addition, purchases of some of our components are denominated in Japanese Yen and Euros. 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 foreign exchange exposure, and exchange rate fluctuations could have an adverse effect on our financial condition and results of

operations in the future.

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### ***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. In addition, we may not be aware of all environmental laws or regulations that could subject us to liability in the U.S. or internationally. 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, and thus a material adverse impact on our business.

### ***Our business is subject to the risks of earthquakes, fire, power outages, floods, and other catastrophic events, and to interruption by man-made disruptions, such as terrorism.***

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 Hayward, California. If any of our facilities were to experience a catastrophic loss, it could disrupt our operations, delay production and shipments, reduce revenue and result in large expenses to repair or replace the facility. In addition, we have in the past experienced, and may in the future experience, extended power outages at our facilities. We do not carry insurance policies that cover potential losses caused by earthquakes or other natural disasters or power loss.

In addition, disruption in supply resulting from natural disasters or other casualties or catastrophic events, such as earthquakes, severe weather such as storms or floods, fires, labor disruptions, power outages, terrorist attacks or political unrest, may result in certain of our suppliers being unable to deliver sufficient quantities of components or raw materials at all or in a timely manner, disruptions in our operations or disruptions in our customers' operations. For example, in 2011, the northern region of Japan experienced a severe earthquake followed by a tsunami. These geological events caused significant damage in that region and have adversely affected Japan's infrastructure and economy. Some of our suppliers are located in Japan and they have experienced, and may experience in the future, shutdowns or disruptions as a result of these types of events, and their operations may be negatively impacted by these events. Many of our customers and suppliers are also located in California, and may be subject to the same risk of seismic activity as described for us above.

To the extent that natural disasters or other calamities or casualties should result in delays or cancellations of customer orders, or the delay in the manufacture or shipment of our products or services, our business, financial condition and operating results would be adversely affected.

### ***Changes in tax rates or tax assets and liabilities could affect results of operations.***

As a global company, we are subject to taxation in the United States and various other countries. Significant judgment is required to determine and estimate worldwide tax liabilities. Our future annual and quarterly tax rates could be affected by numerous factors, including changes in the: (1) applicable tax laws; (2) amount and composition of pre-tax income in countries with differing tax rates; or (3) valuation of our deferred tax assets and liabilities.

In addition, we are subject to regular examination by the Internal Revenue Service and other tax authorities, and from time to time we initiate amendments to previously filed tax returns. We regularly assess the likelihood of favorable or unfavorable outcomes resulting from these examinations and amendments to determine the adequacy of our provision for income taxes, which requires estimates and judgments. Although we believe our tax estimates are reasonable, there can be no assurance that the tax authorities will agree with such estimates. We may have to engage in litigation to achieve the results reflected in the estimates, which may be time-consuming and expensive. There can be no assurance that we will be successful or that any final determination will not be materially different from the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our financial condition and results of operations.

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

The size of our public market capitalization is relatively small, and the average volume of our shares that are traded is relatively 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;





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changes in revenue or earnings estimates or publication of research reports by analysts;

speculation in the press or investment community;

strategic actions by us, our customers 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.

***New regulations related to conflict minerals could adversely impact our business.***

The Dodd-Frank Wall Street Reform and Consumer Protection Act contains provisions to improve transparency and accountability concerning the supply of certain minerals, known as conflict minerals, originating from the Democratic Republic of Congo (DRC) and adjoining countries. As a result, in August 2012 the SEC adopted annual disclosure and reporting requirements for those companies who use conflict minerals mined from the DRC and adjoining countries in their products. These new requirements have required us to perform due diligence efforts in 2013 with further due diligence efforts in 2014. Disclosure will be required beginning in May 2014. There will be costs associated with complying with these disclosure requirements to determine the sources of conflict minerals used in our products and other potential changes to products, processes or sources of supply as a consequence of such verification activities. The implementation of these rules could adversely affect the sourcing, supply and pricing of materials used in our products. As there may be only a limited number of suppliers offering conflict free conflict minerals, we cannot be sure that we will be able to obtain necessary conflict minerals from such suppliers in sufficient quantities or at competitive prices. Also, we may face reputational challenges if we determine that certain of our products contain minerals not determined to be conflict free or if we are unable to sufficiently verify the origins for all conflict minerals used in our products through the procedures we may implement.

***A sale of a substantial number of shares of our common stock by the former owner of AIT may cause the price of our common stock to decline.***

Sales of a substantial number of shares of our common stock in the public market could harm the market price of our common stock. We issued 4.5 million shares of our common stock in connection with our acquisition of AIT, representing approximately 16% of our total common shares outstanding immediately following the completion of the merger. Although we entered into a lock-up and standstill agreement with AIT's former owner, AIT Holding Company, LLC, and certain of its affiliates, which limited sales of the shares, the lock-up period has expired under such agreement and there are no further contractual transfer restrictions on the shares. The shares issued in connection with the merger are thus available for resale in the public market, and such sales could significantly decrease the market price of our common stock. As of March 28, 2014, AIT Holding Company, LLC held approximately 7.5% of our common stock.

***If securities or industry analysts do not publish research or reports about our business, or if they issue an adverse opinion regarding our stock, our stock price and trading volume could decline.***

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The trading market for our common stock is influenced by the research and reports that industry or securities analysts publish about us or our business. If any of the analysts who cover us issue an adverse opinion regarding our stock, our stock price would likely decline. If one or more of these analysts ceases coverage of our company or fails to publish reports on us regularly, we could lose visibility in the financial markets, which in turn could cause our stock price or trading volume to decline.

***We do not currently intend to pay dividends on our common stock and, consequently, your ability to achieve a return on your investment will depend on appreciation in the price of our common stock.***

We do not intend to declare and pay dividends on our capital stock for the foreseeable future. We currently intend to invest our future earnings, if any, to fund our growth. Additionally, the terms of the credit agreement we entered into in July 2012 restricts our ability to pay dividends. Therefore, you are not likely to receive any dividends on your common stock for the foreseeable future.

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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. Mine Safety Disclosures**

Not Applicable.

**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 March 28, 2014:

<b>Exhibit</b>	
<b>Number</b>	<b>Description</b>
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.

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**Exhibit**

<b>Number</b>	<b>Description</b>
32.1	Certification of the Chief Executive Officer and the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Calculation Linkbase Document
101.DEF	XBRL Taxonomy Definition Linkbase Document
101.LAB	XBRL Taxonomy Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

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**SIGNATURES**

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

**ULTRA CLEAN HOLDINGS, INC.**

(Registrant)

Date: May 5, 2014

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

**(Principal Executive Officer and duly authorized signatory)**

Date: May 5, 2014

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

**(Principal Financial Officer and duly authorized signatory)**

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