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

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

(Mark One)

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

For the quarterly period ended June 27, 2008

or

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

For the transition period from to

Commission file number 000-50646

Ultra Clean Holdings, Inc.

(Exact name of registrant as specified in its charter)

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

(650) 323-4100

Registrant s telephone number, including area code

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No o

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

Large accelerated filer o	Accelerated filer þ	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

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

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements

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

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

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

(See accompanying notes to condensed consolidated financial statements.)

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

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

(See accompanying notes to condensed consolidated financial statements)

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

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

Supplemental items:

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

(See accompanying notes to condensed consolidated financial statements)

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

1. Organization, Basis of Presentation and Significant Accounting Policies

Organization - Ultra Clean Holdings, Inc. (the Company) is a developer and supplier of critical subsystems, primarily for the semiconductor capital equipment (SCE) industry. The Company also leverages the specialized skill sets required to support SCE to serve the technologically similar markets in the flat panel, solar and medical device industries. The Company s revenue is derived from the sale of gas delivery systems and other critical subsystems including chemical mechanical planarization (CMP) subsystems, chemical delivery modules, frame and top plate assemblies and process modules and other high level assemblies. The Company s customers are primarily original equipment manufacturers (OEMs) of semiconductor capital equipment.

Basis of Presentation - The unaudited condensed consolidated financial statements included in this quarterly report on Form 10-Q include the accounts of the Company and its wholly-owned subsidiaries and have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP). This financial information reflects all adjustments which are, in the opinion of the Company, normal, recurring and necessary to present fairly the statements of financial position, results of operations and cash flows for the dates and periods presented. The Company s December 28, 2007 balance sheet data were derived from audited financial statements as of that date. All significant intercompany transactions and balances have been eliminated from the information provided.

The unaudited condensed consolidated financial statements should be read in conjunction with the Company s consolidated financial statements for the fiscal year ended December 28, 2007, included in its Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 12, 2008. The Company s results of operations for the three months ended June 27, 2008 are not necessarily indicative of the results to be expected for any future periods.

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

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

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

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

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

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

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

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

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

Stock-Based Compensation The Company maintains a stock-based compensation plan which allows for the issuance of equity-based awards to executives and certain employees. These equity-based awards include stock options, restricted stock awards and restricted stock units.

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

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

Stock Options

The exercise price of each stock option equals the market price of the Company s stock on the date of grant. The estimated fair value of the Company s equity-based awards, less expected forfeitures, is amortized over the awards vesting periods on a straight-line basis. Most options are scheduled to vest over four years and expire no later than ten years from the grant date. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The weighted average assumptions used in the model are outlined in the following table:

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

The Company did not grant stock options during the second quarter of 2008. The weighted average estimated fair value of employee stock option grants for the six months ended June 27, 2008 was $4.71. The computation of the expected volatility assumption used in the Black-Scholes calculations for new grants is based on a combination of the Company s historical volatility and the volatility of similar companies in our industry. The risk-free interest rate assumption is based upon observed interest rates appropriate for the term of the Company s employee stock options. The Company does not currently pay dividends and has no plans to do so in the future. The forfeiture rate is based on the Company s historical option forfeitures, as well as management s expectation of future forfeitures based on current market conditions. When establishing the expected life assumption, the Company reviews annual historical employee exercise behavior of option grants with similar vesting periods.

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

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

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

Employee Stock Purchase Plan

The Company also maintains an employee stock purchase plan (ESPP) that provides for the issuance of shares to all eligible employees of the Company at a discounted price. Under the ESPP, substantially all employees may purchase the Company s common stock through payroll deductions at a price equal to 95 percent of the fair market value of the Company s stock at the end of each applicable purchase period. During the six months ended June 27, 2008 and June 29, 2007, 11,449 and 8,203 shares, respectively, were issued under the Company s ESPP.

Restricted Stock Units and Restricted Stock Awards

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

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

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

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

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

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

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

2. Inventory, net (in thousands)

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

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

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

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

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

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

an indefinite
life.

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

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

5. Borrowing Arrangements

In connection with the acquisition of Sieger in the second quarter of 2006, the Company entered into a borrowing arrangement and an equipment loan with two commercial banks. The loan agreement requires compliance with certain financial covenants, including a leverage and fixed charge coverage target. The loan agreement under the borrowing arrangement with one bank provides senior secured credit facilities in an aggregate principal amount of up to $32.5 million, consisting of a $25.0 million revolving line of credit ($10.0 million of which may be used for the issuance of letters of credit) and a $7.5 million term loan. The aggregate amount of the credit facilities is also subject to a borrowing base equal to 80% of eligible accounts receivable and is secured by substantially all of the Company s assets. Each of the credit facilities will expire on June 29, 2009 and contain certain financial covenants, including minimum profitability and liquidity ratios. As of June 27, 2008, the Company was in compliance with all loan covenants. In addition, the term loan is subject to monthly amortization payments in 36 equal installments. Interest rates on outstanding loans under the credit facilities ranged from 4.50% to 4.25% per annum during the quarter ended June 27, 2008, and were 4.25% as of June 27, 2008. The equipment loan is a 5 year, $5.0 million loan that is secured by certain equipment. The interest rate on the equipment loan was 7.6% per annum as of June 27, 2008. The combined balance outstanding on the borrowing arrangement and equipment loan at June 27, 2008 was $20.5 million, of which $3.4 million is included in other current liabilities.

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6. Stock Repurchase Plan Subsequent Event

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

7. Net Income (Loss) Per Share

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

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

	Three months ended		**Six months ended**	
	June 27, 2008	**June 29, 2007**	**June 27, 2008**	**June 29, 2007**
Numerator:				
Net income (loss)	$ (162)	$ 5,096	$ 1,727	$ 10,281
Denominator:				
Shares used in computation basic:	&			