

FORMFACTOR INC  
Form 10-Q  
October 27, 2011  
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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 September 24, 2011

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: 000-50307

# FormFactor, Inc.

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**13-3711155**  
(I.R.S. Employer  
Identification No.)

**7005 Southfront Road, Livermore, California 94551**

(Address of principal executive offices, including zip code)

**(925) 290-4000**

(Registrant's telephone number, including area code)

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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 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 the 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 definition of "large accelerated filer", "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer

Accelerated filer

Non-accelerated filer   
(Do not check if a smaller reporting company)

Smaller reporting company

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

As of October 20, 2011, 50,460,810 shares of the registrant's common stock, par value \$0.001 per share, were outstanding.



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**FORMFACTOR, INC.**

**FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 24, 2011**

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Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements (Unaudited)****FORMFACTOR, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts)****(Unaudited)**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 24, 2011</b>	<b>September 25, 2010</b>	<b>September 24, 2011</b>	<b>September 25, 2010</b>
Revenues	\$ 52,115	\$ 47,347	\$ 139,101	\$ 144,653
Cost of revenues	40,141	54,541	113,168	150,244
Gross profit (loss)	11,974	(7,194)	25,933	(5,591)
Operating expenses:				
Research and development	10,423	12,825	32,861	43,913
Selling, general and administrative	11,200	16,219	34,741	52,810
Restructuring charges, net	258	8,539	197	14,603
Impairment of long-lived assets	100	55,402	451	56,401
Total operating expenses	21,981	92,985	68,250	167,727
Operating loss	(10,007)	(100,179)	(42,317)	(173,318)
Interest income, net	335	623	1,128	2,120
Other income (expense), net	(75)	3,960	135	3,995
Loss before income taxes	(9,747)	(95,596)	(41,054)	(167,203)
Provision for (benefit from) income taxes	157	231	(2,048)	672
Net loss	\$ (9,904)	\$ (95,827)	\$ (39,006)	\$ (167,875)
Net loss per share:				
Basic and Diluted	\$ (0.20)	\$ (1.90)	\$ (0.77)	\$ (3.35)
Weighted-average number of shares used in per share calculations:				
Basic and Diluted	50,747	50,431	50,719	50,136

The accompanying notes are an integral part of these condensed consolidated financial statements.

Table of Contents**FORMFACTOR, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS****(In thousands, except share and per share amounts)****(Unaudited)**

	September 24, 2011	December 25, 2010
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 140,933	\$ 121,207
Marketable securities	175,099	226,028
Restricted cash		383
Accounts receivable, net	29,142	28,598
Inventories	20,647	25,003
Deferred tax assets	304	329
Prepaid expenses and other current assets	11,250	14,743
Total current assets	377,375	416,291
Restricted cash	297	297
Property, plant and equipment, net	34,872	37,311
Deferred tax assets	7,417	5,445
Other assets	3,987	6,710
Total assets	\$ 423,948	\$ 466,054
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 18,120	\$ 14,948
Accrued liabilities	14,170	24,045
Income taxes payable		1,894
Deferred revenue	5,960	4,637
Total current liabilities	38,250	45,524
Long-term income taxes payable	4,155	4,248
Deferred rent and other liabilities	4,205	5,081
Total liabilities	46,610	54,853
Commitments and contingencies (Note 16)		
Stockholders' equity:		
Preferred stock, \$0.001 par value: 10,000,000 shares authorized; no shares issued and outstanding at September 24, 2011 and December 25, 2010, respectively		
Common stock, \$0.001 par value: 250,000,000 shares authorized; 50,460,810 and 50,587,917 shares issued and outstanding at September 24, 2011 and December 25, 2010, respectively		
	52	52
Additional paid-in capital	655,449	651,263
Accumulated other comprehensive income	2,983	2,027
Accumulated deficit	(281,146)	(242,141)
Total stockholders' equity	377,338	411,201
Total liabilities and stockholders' equity	\$ 423,948	\$ 466,054

The accompanying notes are an integral part of these condensed consolidated financial statements.



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## FORMFACTOR, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Nine Months Ended	
	September 24, 2011	September 25, 2010
<b>Cash flows from operating activities:</b>		
Net loss	\$ (39,006)	\$ (167,875)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	8,593	24,720
Amortization of investments	385	340
Stock-based compensation expense	9,661	13,371
Deferred income tax benefit	(2,513)	(87)
Recovery of doubtful accounts receivable	(266)	(717)
Provision for excess and obsolete inventories	4,867	6,754
Loss (gain) on disposal of long-lived assets	(31)	443
Impairment of long-lived assets	451	56,402
Non-cash restructuring	(1,582)	8,717
Gain on release of secured borrowing		(3,481)
Foreign currency transaction gains	(542)	(206)
Changes in assets and liabilities:		
Accounts receivable	453	(4,664)
Inventories	(581)	(13,987)
Prepaid expenses and other current assets	2,524	1,276
Refundable income taxes	(12)	26,357
Other assets	1,896	57
Accounts payable	3,262	(2,297)
Accrued liabilities	(9,390)	1,665
Income tax payable	(1,253)	(418)
Deferred rent	(11)	(832)
Deferred revenues	1,322	(3,820)
Net cash used in operating activities	(21,773)	(58,282)
<b>Cash flows from investing activities:</b>		
Acquisition of property, plant and equipment	(4,874)	(22,479)
Proceeds from sales of property, plant and equipment	33	144
Purchases of marketable securities	(182,213)	(257,106)
Proceeds from maturities of marketable securities	232,980	322,223
Proceeds from sales of marketable securities		9,000
Change in restricted cash	383	
Net cash provided by investing activities	46,309	51,782
<b>Cash flows from financing activities:</b>		
Proceeds from issuances of common stock and awards, net of issuance costs	3,512	3,635
Purchase and retirement of common stock	(8,536)	
Net cash provided by (used in) financing activities	(5,024)	3,635
Effect of exchange rate changes on cash and cash equivalents	214	(624)
Net increase (decrease) in cash and cash equivalents	19,726	(3,489)



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Cash and cash equivalents, beginning of period		121,207		122,043
Cash and cash equivalents, end of period	\$	140,933	\$	118,554
<b>Supplemental cash flow disclosures:</b>				
Changes in accounts payable and accrued liabilities related to property and equipment purchases	\$	(192)	\$	1,375
Income taxes paid (refunded), net	\$	1,258	\$	(25,023)

The accompanying notes are an integral part of these condensed consolidated financial statements.

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**FORMFACTOR, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**Note 1 Basis of Presentation and Summary of Significant Accounting Policies**

**Basis of presentation.** The accompanying unaudited condensed consolidated interim financial statements of FormFactor, Inc. and our subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the U.S. Securities and Exchange Commission (the SEC ). Our interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary to fairly present our financial position, results of operations and cash flows have been included. Operating results for the three and nine months ended September 24, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011, or for any other period. The balance sheet at December 25, 2010 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. The condensed consolidated financial statements include our accounts as well as those of our wholly-owned subsidiaries after elimination of all significant inter-company balances and transactions.

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in our condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates, and material effects on our consolidated operating results and financial position may result.

These financial statements and notes should be read with the consolidated financial statements and notes thereto for the year ended December 25, 2010 included in our Annual Report on Form 10-K filed with the SEC on February 17, 2011.

**Fiscal year.** We operate on a 52/53 week fiscal year, whereby the fiscal year ends on the last Saturday of December. Fiscal 2011 will end on December 31, 2011, and will consist of 53 weeks.

**Reclassifications.** Certain reclassifications have been made to the prior period's Condensed Consolidated Balance Sheet and Statement of Cash Flows to conform to the current period presentation.

**Significant Accounting Policies.** Other than the accounting policies discussed in Note 2 Recent Accounting Pronouncements and Other Reporting Considerations, our significant accounting policies have not materially changed during the three and nine months ended September 24, 2011 from those disclosed in our Annual Report on Form 10-K for the year ended December 25, 2010.

**Note 2 Recent Accounting Pronouncements and Other Reporting Considerations**

*Fair Value*

Effective December 26, 2010, as required, we adopted the guidance to amend the disclosure requirements related to recurring and nonrecurring fair value measurements. Specifically, we have adopted the guidance requiring the disclosure of the roll forward of activities on purchases, sales, issuances and settlements of the assets and liabilities measured using significant unobservable inputs (Level 3 fair value measurements). Other than requiring additional disclosures, adoption of this new guidance in the first quarter of fiscal 2011 did not have a material impact on our consolidated financial statements.

Additionally, in May 2011 updated authoritative guidance to amend existing requirements for fair value measurements and disclosures was issued. The guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy and requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for fair value measurements of financial assets and liabilities as well as instruments classified in shareholders' equity. The guidance will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and are to be applied prospectively. This new guidance impacts how we report on fair value measurements only, and will have no effect on our results of operations, financial position or liquidity upon its required adoption by us on January 1, 2012.

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*Revenue Recognition*

In October 2009, additional authoritative guidance that modifies accounting for revenue arrangements with multiple deliverables was issued. The guidance eliminates the residual method of revenue recognition and establishes a hierarchy for determining the selling price of a deliverable in a sale arrangement whereby the selling price for each deliverable is based on vendor-specific objective evidence ( VSOE ) if available, third-party evidence ( TPE ) if VSOE is not available, or estimated selling price if neither VSOE or TPE is available. As required, we adopted this guidance effective December 26, 2010 on a prospective basis for revenue arrangements entered into or materially modified after the adoption date. The adoption of the additional authoritative guidance modifying revenue recognition accounting standards did not have a material impact on our consolidated financial position, results of operations, or cash flows for the three and nine months ended September 24, 2011, nor is it expected to have a material impact on total net revenues for the year ended December 31, 2011 based on current business practices.

*Comprehensive Income*

In June 2011 authoritative guidance that addresses the presentation of comprehensive income in interim and annual reporting of financial statements was issued. The guidance is intended to improve the comparability, consistency, and transparency of financial reporting and to increase the prominence of items reported in other comprehensive income by eliminating the option to present components of other comprehensive income as part of the statement of changes in stockholders' equity. Such changes in stockholders' equity will be required to be disclosed in either a single continuous statement of comprehensive income or in two separate but consecutive statements. The guidance will be effective for fiscal years, and interim periods within those years, beginning after December 15, 2011, and should be applied retrospectively for all periods presented. Early adoption is permitted. This new guidance impacts how we report comprehensive income only, and will have no effect on our results of operations, financial position or liquidity upon its required adoption by us on January 1, 2012.

**Note 3 Concentration of Credit and Other Risks**

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash equivalents, investments and trade receivables. Our cash equivalents and marketable securities are held in safekeeping by large, creditworthy financial institutions. We either hold our excess cash on deposit with U.S. banks or invest our excess cash in government and agency bonds, money market funds and corporate obligations. We have established guidelines relative to credit ratings, diversification and maturities that seek to maintain safety and liquidity.

We sell our products to large multinational semiconductor manufacturers primarily located in Asia and North America. Three customers represented 25%, 22%, and 14% of total revenues during the three months ended September 24, 2011, and three customers represented 22%, 17%, and 11% of total revenues during the three months ended September 25, 2010. Three customers represented 18%, 16% and 12% of total revenues during the nine months ended September 24, 2011, and three customers represented 22%, 14% and 13% of total revenues during the nine months ended September 25, 2010. No other customer accounted for more than 10% of total revenues in any of these fiscal periods.

We have significant accounts receivables concentrated with a few customers in the semiconductor industry. While our allowance for doubtful accounts balance is based on historical loss experience along with anticipated economic trends, unanticipated financial instability in the semiconductor industry could lead to higher than anticipated losses. As of September 24, 2011, three customers accounted for approximately 31%, 12% and 10% of gross accounts receivable. At December 25, 2010, three customers accounted for approximately 21%, 19% and 11% of

gross accounts receivable. No other customer accounted for more than 10% of gross accounts receivable at either of these dates.

**Note 4 Restructuring Charges**

Restructuring charges include costs related to employee termination benefits, cost of long-lived assets abandoned or impaired, as well as contract termination costs. Restructuring charges are reflected separately as Restructuring charges, net in the Condensed Consolidated Statements of Operations.

*2010 Restructuring Activities*

We recorded \$29,000 and \$3.6 million in restructuring charges in the three and nine months ended September 25, 2010, respectively, as part of our then-current regionalization strategy (the Q1 2010 Restructuring Plan ). These charges consisted of termination benefits related to reductions in work force of 106 full-time positions, which were all related to severance and related benefits.

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In the second quarter of fiscal 2010, we announced a series of corporate initiatives, including a reduction in workforce, which represented a renewed focus on streamlining and simplifying our operations as well as reducing our quarterly operating costs (the Q2 2010 Restructuring Plan). These actions included a reduction in workforce impacting 67 employees spread across all functions of the organization, as well as a reduction in the scope of the previously contemplated manufacturing operations in Korea, resulting in a reduction of workforce of 16 employees related to the assembly and test function. In conjunction with this action, we also undertook a plan to rescind the previously issued severance arrangements for certain employees impacted by the Q1 2010 Restructuring Plan. As a result of this rescission plan, as of September 25, 2010, we had reversed the existing accrual of \$3.3 million for certain of the severance costs booked in conjunction with the Q1 2010 Restructuring Plan, including the accrued retention bonus to date.

We recorded \$4.9 million and \$0.2 million in charges for the Q2 2010 Restructuring Plan in the second and third quarter of fiscal 2010, respectively, primarily for severance and related benefits. Additionally, in conjunction with the Q2 2010 Restructuring Plan we identified certain equipment and software assets related to our assembly and test operations in Korea that would no longer be utilized. As a result, we recorded impairment charges of approximately \$0.9 million and \$85,000 in the second and third quarter of fiscal 2010, respectively, representing the net book value of these assets.

In the third quarter of fiscal 2010, we announced a restructuring plan (the Q3 2010 Restructuring Plan) to cease the transition of manufacturing operations to Singapore. This decision resulted in a reduction in force of 58 employees at our Singapore facility. The manufacturing activities that were scheduled to be transitioned to Singapore remained in Livermore, and Livermore continued as the primary manufacturing operating location for the Company. In conjunction with the Q3 2010 Restructuring Plan, we also undertook a reduction in force that involved two additional individuals in our Livermore operations.

In conjunction with the Q3 2010 Restructuring Plan, we recorded charges of \$1.0 million for severance and related benefits and impairment charges of \$7.6 million for certain equipment and leasehold improvements in Singapore that would no longer be utilized. In addition, due to the combined effect of the significant change in our business strategy in connection with the Q3 2010 Restructuring Plan, recurring operating losses and the sustained decline in the Company's stock price, we reviewed the recoverability of our long-lived assets in the third quarter of fiscal 2010, as discussed in Note 10.

The activities comprising the above reductions in force were substantially completed by the end of the first quarter of fiscal 2011.

In addition to the above, we executed certain additional restructuring actions during the remainder of fiscal 2010. The ending restructuring accrual of \$1.8 million as of December 25, 2010 reflects the unpaid amounts related to these actions as of that date.

*2011 Restructuring Activities*

In the first quarter of fiscal 2011, we implemented a restructuring plan (the Q1 2011 Restructuring Plan) which resulted in the reduction of our global workforce by 13 full-time employees across the organization. We recorded \$1.1 million in charges for severance and related benefits during the quarter related to this plan. The activities comprising this reduction in workforce were substantially completed by the end of the second quarter of fiscal 2011.

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In the second quarter of fiscal 2011, we implemented a restructuring plan (the Q2 2011 Restructuring Plan ) which resulted in the reduction of our global workforce by 13 full-time employees across the organization. We recorded \$0.6 million in charges for severance and related benefits during the quarter related to this plan. The activities comprising this reduction in workforce were substantially completed by the end of the third quarter of fiscal 2011.

Additionally, in the second quarter of fiscal 2011 we executed an amendment to the existing lease arrangement for our facility in Singapore which released us from our obligations related to the floor previously utilized for manufacturing in this facility. We were also granted a rent reduction for the remaining occupied facilities in this building. We had previously recorded certain asset retirement obligations and accruals related to our ceasing use of these facilities in connection with a prior restructuring action. As a result, our Condensed Consolidated Statement of Operations for the nine months ended September 24, 2011 includes a benefit of \$1.5 million recorded to Restructuring charges, net .

In the third quarter of fiscal 2011, we implemented a restructuring plan (the Q3 2011 Restructuring Plan ) which resulted in the reduction of our global workforce by four full-time employees primarily in our procurement and logistics organizations. We recorded \$0.3 million in charges for severance and related benefits during the quarter related to this plan. The activities comprising this reduction in workforce are expected to be completed by the end of the fourth quarter of fiscal 2011.

The liabilities we have accrued represent our best estimate of the obligations we expect to incur and could be subject to adjustment as market conditions change. The remaining cash payments associated with our various reductions in workforce are expected to be paid by the end of the fourth quarter of fiscal 2011. As such, the restructuring accrual is recorded as a current liability within Accrued liabilities in the Condensed Consolidated Balance Sheets.

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The activities in the restructuring accrual for the nine months ended September 24, 2011 were as follows (in thousands):

	<b>Employee Severance and Benefits</b>	<b>Contract Termination and Other</b>	<b>Total</b>
Accrual at December 25, 2010	\$ 1,382	\$ 451	\$ 1,833
Q1 2011 Restructuring Plan charges	1,082		1,082
Cash payments	(1,633)	(53)	(1,686)
Other adjustments	(40)		(40)
Accrual at March 26, 2011	791	398	1,189
Q2 2011 Restructuring Plan charges	627		627
Singapore facility restructuring adjustments		(374)	(374)
Cash payments	(728)	(24)	(752)
Other adjustments	(345)		(345)
Accrual at June 25, 2011	345		345
Q3 2011 Restructuring Plan charges	265		265
Cash payments	(265)		(265)
Other adjustments	(63)		(63)
Accrual at September 24, 2011	\$ 282	\$	\$ 282

### **Note 5 Fair Value**

We use fair value measurements to record fair value adjustments to certain financial and non-financial assets and to determine fair value disclosures. Our marketable securities are financial assets recorded at fair value on a recurring basis. We also have certain manufacturing equipment held for sale which is measured at fair value on a non-recurring basis and included within Prepaid expenses and other current assets in the Condensed Consolidated Balance Sheets.

The accounting standard for fair value defines fair value, establishes a framework for measuring fair value and requires disclosures about fair value measurements. Fair value is defined as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. When determining the fair value measurements for assets and liabilities required to be recorded at fair value, we consider the principal or most advantageous market in which we would transact and consider assumptions that market participants would use when pricing the asset or liability, such as inherent risk, transfer restrictions and risk of nonperformance. The accounting standard establishes a fair value hierarchy that requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. A financial instrument's categorization within the fair value hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The standard describes a fair value hierarchy based on three levels of inputs, the first two of which are considered observable and the last unobservable, that may be used to measure fair value. We apply the following fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

- Level 1 - Quoted prices in active markets for identical assets or liabilities.
  
- Level 2 - Inputs, other than the quoted prices in active markets, which are observable either directly or indirectly.



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- Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

### *Assets Measured at Fair Value on a Recurring Basis*

We measure and report certain assets and liabilities at fair value on a recurring basis, including money market funds, U.S. treasury securities, agency securities and foreign currency derivatives (see Note 17 Derivative Financial Instruments of the Notes to Condensed Consolidated Financial Statements for discussion of fair value of foreign currency derivatives). The following tables represent the fair value hierarchy for our other financial assets (cash equivalents and marketable securities):

Fair value measured on a recurring basis as of September 24, 2011 (in thousands):

	Level 1		Level 2		Total
<b>Assets:</b>					
Cash equivalents					
Money market funds	\$	108,417	\$		\$ 108,417
U. S. Treasury			5,000		5,000
Commercial paper			7,000		7,000
<b>Marketable securities</b>					
U. S. Treasury			76,760		76,760
Agency securities			89,841		89,841
Commercial paper			8,498		8,498
<b>Total</b>	<b>\$</b>	<b>108,417</b>	<b>\$</b>	<b>187,099</b>	<b>\$ 295,516</b>

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Fair value measured on a recurring basis as of December 25, 2010 (in thousands):

	Level 1	Level 2	Total
<b>Assets:</b>			
Cash equivalents			
Money market funds	\$ 82,996	\$	\$ 82,996
Commercial paper		16,991	16,991
<b>Marketable securities</b>			
U. S. Treasury		105,865	105,865
Agency securities		108,173	108,173
Commercial paper		11,990	11,990
<b>Total</b>	<b>\$ 82,996</b>	<b>\$ 243,019</b>	<b>\$ 326,015</b>

The Level 1 assets consist of our money market fund deposits. The Level 2 assets consist of our available-for-sale investment portfolio, which are valued utilizing a market approach. Our investments are priced by pricing vendors who provided observable inputs for their pricing without applying significant judgments. Broker's pricing is used mainly when a quoted price is not available, the investment is not priced by our pricing vendors or when a broker price is more reflective of fair values in the market in which the investment trades. Our broker-priced investments are labeled as Level 2 investments because fair values of these investments are based on similar assets without applying significant judgments. In addition, all of our investments have a sufficient level of trading volume to demonstrate that the fair values used are appropriate for these investments.

We did not have any significant transfers of assets measured at fair value on a recurring basis to or from Level 1 and Level 2 during the periods ended September 24, 2011 and September 25, 2010.

### *Assets Measured at Fair Value on a Nonrecurring Basis*

All of our long-lived assets measured at fair value on a nonrecurring basis were classified as Level 3 assets within the fair value hierarchy. We did not recognize any realized gains or losses on such assets during the three and nine months ended September 24, 2011, respectively.

At the end of fiscal 2010, we had a building held for sale in Livermore, California, which was classified as Level 2 because the estimated fair value of the building was determined using inputs that reflected the assumptions market participants would use in pricing the building developed based on market data obtained from sources independent of us. During the quarter ended March 26, 2011 we placed this building back into service at its carrying value of \$0.8 million, resulting in a reclassification of the balance from Prepaid expenses and other current assets to

Property, plant and equipment, net in the Condensed Consolidated Balance Sheet. See Note 10 Long-lived Assets of the Notes to the Condensed Consolidated Financial Statements for more information.

At the end of fiscal 2010, we also had certain manufacturing equipment held for sale in Livermore, California which was classified as Level 3 as we used unobservable inputs in their valuation reflecting our assumptions that market participants would use in pricing this asset due to the absence of recent comparable market transactions and inherent lack of liquidity. As of both September 24, 2011 and December 25, 2010, our held for sale assets in Livermore were valued at \$0.4 million and continued to be classified as Level 3 based on the fact that we used unobservable inputs in their valuation reflecting our assumptions that market participants would use in pricing this asset due to the absence of

recent comparable market transactions.

Other than the building previously held for sale that was put into service during the three months ended March 26, 2011, we did not have any assets that were transferred to or from Level 3 during the three and nine months ended September 24, 2011 and September 25, 2010.

Our fair value processes include controls that are designed to ensure appropriate fair values are recorded. Such controls include model validation, review of key model inputs, and analysis of period-over-period fluctuations and independent recalculation of prices.

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We classify our marketable debt securities as available-for-sale. All marketable securities represent the investment of funds available for current operations, notwithstanding their contractual maturities. Such marketable securities are recorded at fair value and unrealized gains and losses are recorded in accumulated other comprehensive income until realized.

Marketable securities at September 24, 2011 consisted of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. Treasury	\$ 76,464	\$ 297	\$ (1)	\$ 76,760
Agency Securities	89,753	122	(34)	89,841
Commercial Paper	8,498			8,498
	\$ 174,715	\$ 419	\$ (35)	\$ 175,099

Marketable securities at December 25, 2010 consisted of the following (in thousands):

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U. S. Treasury	\$ 105,513	\$ 372	\$ (20)	\$ 105,865
Agency Securities	108,361	36	(224)	108,173
Commercial Paper	11,988	2		11,990
	\$ 225,862	\$ 410	\$ (244)	\$ 226,028

The marketable securities with gross unrealized losses have been in a loss position for less than 12 months as of September 24, 2011 and December 25, 2010, respectively.

When evaluating the investments for other-than-temporary impairment, we review factors such as the length of time and extent to which fair value has been below the amortized cost basis, review of current market liquidity, interest rate risk, the financial condition of the issuer, as well as credit rating downgrades. We believe that the unrealized losses are not other-than-temporary. We do not have a foreseeable need to liquidate the portfolio and anticipate recovering the full cost of the securities either as market conditions improve, or as the securities mature.

Contractual maturities of marketable securities as of September 24, 2011 were as follows (in thousands):

Amortized Cost	Fair Value
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Due in one year or less	\$	71,793	\$	71,923
Due after one year to three years		102,922		103,176
	\$	174,715	\$	175,099

Realized gains and losses on sales and maturities of marketable securities were immaterial for the three and nine months ended September 24, 2011 and September 25, 2010, respectively.

Table of Contents**Note 7 Allowance for Doubtful Accounts**

We recorded a reduction in provision for doubtful accounts of \$0.6 million in the first quarter of fiscal 2011 primarily due to the receipt of payments totaling \$0.3 million for accounts receivable previously reserved and the write-off of previously reserved accounts receivable in the amount of \$0.3 million. We did not record any significant new allowances in the second or third quarters of fiscal 2011, nor did we release any previously reserved bad debts. A reconciliation of the changes in our allowance for doubtful accounts receivable consisted of the following activity for our quarterly fiscal periods ended September 24, 2011 and September 25, 2010, respectively (in thousands):

	<b>Allowance for Doubtful Accounts Receivable Activity for fiscal quarters ended:</b>			
	<b>September 24, 2011</b>		<b>September 25, 2010</b>	
Beginning balance	\$	847	\$	9,260
Additions				
Deductions		(610)		(147)
First fiscal quarter ending balance		237		9,113
Additions		28		315
Deductions				(496)
Second fiscal quarter ending balance		265		8,932
Additions				
Deductions				(7,732)
Third fiscal quarter ending balance	\$	265	\$	1,200

**Note 8 Inventories**

Inventories consisted of the following (in thousands):

	<b>September 24, 2011</b>		<b>December 25, 2010</b>	
Raw materials	\$	6,557	\$	2,736
Work-in-progress		8,366		16,807
Finished goods		5,724		5,460
	\$	20,647	\$	25,003

We record provisions for excess and obsolete inventory based on forecasts of future demand. While management believes the estimates and assumptions underlying its current forecasts are reasonable, there is risk that additional charges may be necessary if current forecasts are greater than actual demand.

**Note 9 Warranty**

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We offer warranties on certain products and record a liability for the estimated future costs associated with warranty claims, which is based upon historical experience and our estimate of the level of future costs. Warranty costs are reflected in the Condensed Consolidated Statement of Operations as a cost of revenues. A reconciliation of the changes in our warranty accrual liability (included in *Accrued liabilities* in the Condensed Consolidated Balance Sheets) consisted of the following activity for our quarterly fiscal periods ended September 24, 2011 and September 25, 2010, respectively (in thousands):

	<b>Warranty Accrual Activity</b>			
	<b>for fiscal quarters ended:</b>			
	<b>September 24,</b>		<b>September 25,</b>	
	<b>2011</b>		<b>2010</b>	
Beginning balance	\$	433	\$	732
Accrual (release) of warranties during the period		(180)		(396)
Settlements made during the period		(64)		(29)
First fiscal quarter ending balance		189		307
Accrual (release) of warranties during the period		322		254
Settlements made during the period		(193)		(154)
Second fiscal quarter ending balance		318		407
Accrual (release) of warranties during the period		612		325
Settlements made during the period		(170)		(327)
Third fiscal quarter ending balance	\$	760	\$	405

Table of Contents**Note 10 Long-lived Assets***Impairment of Long-lived Assets*

During the three and nine months ended September 24, 2011 and September 25, 2010, we recorded impairments in the carrying amount of our long-lived assets and assets held for sale. The following table summarizes the components of the impairments (in thousands):

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Impairment of long-lived assets:				
Restructuring	\$	\$ 7,672	\$	\$ 8,530
Assets held for sale		342		342
Assets to be disposed of other than sale	100	1,957	451	2,956
Intangible assets		1,082		1,082
Enterprise-wide impairment		52,021		52,021
Total	\$ 100	\$ 63,074	\$ 451	\$ 64,931

*Restructuring*

In conjunction with the Q2 2010 Restructuring Plan we recorded an impairment charge of approximately \$1.0 million in fiscal 2010 to write off certain equipment and software assets related to our assembly and test operations in Korea that would no longer be utilized. In addition, in conjunction with the Q3 2010 Restructuring Plan, we recorded an impairment charge of \$7.6 million for certain assets related to our Singapore manufacturing operations. This impairment was composed primarily of \$5.8 million for leasehold improvements, \$0.6 million for manufacturing equipment and \$0.6 million for software and system assets related to the manufacturing operations that will be taken out of service or abandoned, as well as \$0.6 million to adjust the carrying amount of certain equipment determined to be held for sale. All of these charges were included within Restructuring charges, net in the Condensed Consolidated Statements of Operations for the three and nine months ended September 25, 2010.

We have not recorded any impairment charges related to our restructuring activity during fiscal 2011 to date.

*Assets held for sale*

In the third quarter of fiscal 2010, we recorded aggregated impairment charges of \$0.3 million in conjunction with the write down of a building held for sale to its estimated fair value and certain furniture and fixtures at our Livermore facility that was determined to be held for sale. These impairments were included within Impairment of long-lived assets in the Condensed Consolidated Statements of Operations for the three and nine months ended September 25, 2010.



We have not recorded any impairment charges related to our assets held for sale during fiscal 2011 to date.

*Assets to be disposed of other than sale*

In the second quarter of fiscal 2010, we recorded an impairment charge of \$1.0 million related to the termination of an on-going construction-in-progress project. In the third quarter of fiscal 2010, we recorded an impairment charge of \$2.0 million for certain assets to be disposed of other than sale. This charge was composed of an impairment of \$0.3 million related to certain leasehold improvements that will be abandoned as a result of the consolidation of office space in Livermore and an impairment of \$1.7 million related to certain construction-in-progress projects for the development and build of manufacturing equipment as well as additional related equipment that was in-service and was identified as excess capacity. These projects were terminated during the quarter ended September 25, 2010 and as a result these assets were fully impaired.

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During the three months ended March 26, 2011 we recorded an impairment of \$0.4 million related to the termination of aspects of an on-going project related to certain software development for internal use that had been recorded in construction-in-progress. Additionally, during the three months ended September 24, 2011, we recorded an impairment of \$0.1 million related to the termination of additional on-going projects that had been recorded in construction-in-progress.

All of these charges are included in Impairment of long-lived assets in the Condensed Consolidated Statements of Operations in their respective periods.

*Intangible assets*

During the third quarter of fiscal 2010, the combination of various factors, including our renewed focus on simplifying and refocusing our operations on our core competencies, resulted in our decision to reduce efforts geared at licensing and marketing the software underlying certain of our intangible assets related to precision motion control automation that were acquired in conjunction with our acquisition of certain assets in 2009 through a bankruptcy proceeding. As a result, we performed an impairment analysis of these purchased intangible assets during the third quarter of fiscal 2010. Based on the results of the analysis, we recorded an impairment charge of \$1.1 million for the carrying amount of the impaired assets in the quarter ended September 25, 2010, which was included in Impairment of long-lived assets in the Condensed Consolidated Statements of Operations.

We have not recorded any impairment charges related to our intangible assets during fiscal 2011 to date.

*Enterprise-wide impairment*

At the end of the third quarter of fiscal 2010, in addition to the specific impairments discussed above, we determined that an enterprise-wide impairment analysis of our long-lived assets was required due to the combined effect of a sustained decline in the Company's stock price, a significant change in our business strategy in connection with the Q3 2010 Restructuring Plan, and recurring operating losses and net cash outflows from operations. Accordingly, management reviewed the recoverability of its long-lived assets in the third quarter of fiscal 2010.

We determined our long-lived asset group to be our consolidated long-lived assets as we had determined that we operated as one reporting unit and segment. This asset group included property and equipment, as well as purchased intangible assets. The recoverability of assets to be held and used was measured by comparing the carrying amount of these assets, after adjustment for the various specific impairments discussed above, to the estimated undiscounted future cash flows expected to be generated by the assets. If the carrying amount of the asset exceeds its estimated undiscounted future net cash flows, an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset.

As a result of this analysis, we concluded that our business was not able to fully recover the carrying amount of our assets. Accordingly, we reviewed the carrying amounts at September 25, 2010 of all of our long-lived assets for impairment. The review involved estimating the fair value in an exchange transaction of our asset group, comparing such fair value to the carrying amount of the asset group, after adjustment for the

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various specific impairments discussed above, and recording impairment charges to reduce the pre-impairment carrying amount of the asset group to its estimated fair value. Based on this analysis, an impairment charge of approximately \$52.0 million was recorded as of September 25, 2010. This charge, which was included in Impairment of long-lived assets in the Condensed Consolidated Statements of Operations, was composed of \$27.7 million for leasehold improvements, \$11.2 million for manufacturing equipment, \$8.5 million for computer equipment, \$4.4 million for construction-in-progress and \$0.2 million for purchased intangible assets.

We have not recorded any impairment charges related to an enterprise-wide impairment during fiscal 2011 to date.

### *Long-lived Assets*

Property, plant and equipment consisted of the following (in thousands):

	September 24, 2011		December 25, 2010
Building	\$ 790	\$	
Machinery and equipment	123,773		115,847
Computer equipment and software	36,294		35,493
Furniture and fixtures	6,082		6,180
Leasehold improvements	70,472		69,934
	237,411		227,454
Less: Accumulated depreciation, amortization and enterprise-wide impairment	(216,343)		(207,992)
	21,068		19,462
Construction-in-progress	13,804		17,849
	\$ 34,872	\$	37,311

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During the quarter ended March 26, 2011 we placed a building previously identified as held for sale back into service at its carrying value of \$0.8 million. This amount represents the lesser of its carrying amount before the building was classified as held for sale, adjusted for any depreciation that would have been recognized had the building been continuously classified as held and used, or the fair value at the date of the subsequent decision not to sell. The building is being depreciated over its estimated remaining useful life of ten years.

At September 24, 2011, the carrying amount of our intangible asset, which consists of purchased intellectual property, was \$3.5 million, with \$5.9 million as the gross amount and \$2.4 million as the accumulated amortization. We recorded \$0.3 million and \$0.9 million of amortization expense for our intangible asset during the three and nine months ended September 24, 2011, respectively, all of which was charged to cost of revenues. The intangible asset had a remaining amortization period of 3.0 years at September 24, 2011. The intangible asset is included in Other assets in the Condensed Consolidated Balance Sheets.

**Note 11 Comprehensive Loss**

Comprehensive loss includes foreign currency translation adjustments and unrealized gains (losses) on available-for-sale securities, the impact of which has been excluded from net income and reflected as components of stockholders' equity.

Components of comprehensive loss were as follows (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 24, 2011</b>	<b>September 25, 2010</b>	<b>September 24, 2011</b>	<b>September 25, 2010</b>
Net loss	\$ (9,904)	\$ (95,827)	\$ (39,006)	\$ (167,875)
Unrealized gain on investments, net	(82)	(171)	127	179
Cumulative translation adjustments	255	758	829	729
Comprehensive loss	\$ (9,731)	\$ (95,240)	\$ (38,050)	\$ (166,967)

Components of accumulated other comprehensive income was as follows (in thousands):

	<b>September 24, 2011</b>	<b>December 25, 2010</b>
Unrealized gain (loss) on marketable securities, net of tax of \$393 at September 24, 2011 and \$299 at December 25, 2010, respectively	\$ (9)	\$ (136)
Cumulative translation adjustments	2,992	2,163
Accumulated other comprehensive income	\$ 2,983	\$ 2,027

**Note 12 Stockholders' Equity**

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### *Common Stock Repurchase Program*

On October 20, 2010, our Board of Directors authorized a program to repurchase up to \$50.0 million of outstanding common stock. Under the authorized stock repurchase program, we may repurchase shares from time to time on the open market; the pace of repurchase activity will depend on levels of cash generation, current stock price, and other factors. The stock repurchase program was announced on October 26, 2010 and had a scheduled expiration of October 19, 2011. The program may be modified or discontinued at any time. During fiscal year 2010 we repurchased and retired 70,000 shares of common stock for \$0.6 million under this repurchase authorization. During the first fiscal quarter of 2011 we repurchased and retired 262,712 shares for \$2.3 million, during the second fiscal quarter of 2011 we repurchased and retired 117,437 shares for \$1.0 million, and during the third fiscal quarter of 2011 we repurchased and retired an additional 695,134 shares for \$5.5 million.

On October 12, 2011, our Board of Directors authorized the extension of this repurchase program through October 19, 2012. Under the existing program, we may repurchase up to \$40.5 million of outstanding common stock during the program period. The terms and conditions of the extended repurchase program remain the same as those in the original program approved in fiscal 2010.

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Repurchased shares are retired upon the settlement of the related trade transactions. Our policy related to repurchases of our common stock is to charge the excess of cost over par value to additional paid-in capital. All repurchases were made in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended.

### *Equity Incentive Plans*

We have four equity incentive plans for which we have reserved shares for issuance upon the exercise of stock options: the 1996 Stock Option Plan, the Incentive Option Plan and the Management Incentive Option Plan (together, the Prior Plans), and the 2002 Equity Incentive Plan (the 2002 Plan), which became effective in April 2002. Upon the effectiveness of the 2002 Plan, we ceased granting any equity awards under the Prior Plans, although forfeited, repurchased, cancelled or terminated Prior Plan shares are transferred to the 2002 Plan.

### *Stock Options*

Stock option activity under the Prior Plans and the 2002 Plan during the nine months ended September 24, 2011 is set forth below:

	Options Outstanding	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life in Years	Aggregate Intrinsic Value
Balances, December 25, 2010	5,318,387	\$ 14.53		
Options granted	202,250	8.94		
Options exercised	(12,515)	6.23		
Options cancelled:				
Forfeited	(70,275)	9.86		
Expired	(105,289)	29.18		
Balances, March 26, 2011	5,332,558	14.11		
Options granted	257,500	10.33		
Options exercised	(7,485)	6.50		
Options cancelled:				
Forfeited	(74,993)	9.34		
Expired	(274,166)	21.67		
Balances, June 25, 2011	5,233,414	13.61		
Options granted				
Options exercised	(121,280)	6.50		
Options cancelled:				
Forfeited	(99,655)	10.00		
Expired	(140,470)	28.16		
Balances, September 24, 2011	4,872,009	\$ 13.44	4.62	\$ 14,085
Vested and expected to vest at September 24, 2011	4,544,470	\$ 13.69	4.53	\$ 14,085
Exercisable at September 24, 2011	1,652,151	\$ 20.45	2.56	\$ 14,085

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The intrinsic value of option exercises was \$0.2 million during the three and nine months ended September 24, 2011. Cash received from stock option exercises during the three and nine months ended September 24, 2011 was \$0.8 million and \$0.9 million, respectively. We did not realize any gross tax benefits in connection with these exercises.

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*Restricted Stock Units*

Restricted stock unit activity under the 2002 Plan during the nine months ended September 24, 2011 is set forth below:

	Units		Weighted Average Grant Date Fair Value
Non-vested restricted stock units at December 25, 2010	1,372,912	\$	16.29
Awards granted	51,600		8.89
Awards released	(103,525)		17.92
Awards cancelled	(112,118)		17.08
Non-vested restricted stock units at March 26, 2011	1,208,869		15.77
Awards granted	585,655		10.28
Awards released	(313,741)		16.50
Awards cancelled	(54,654)		15.40
Non-vested restricted stock units at June 25, 2011	1,426,129		13.37
Awards granted	22,940		8.59
Awards released	(27,300)		10.96
Awards cancelled	(40,842)		14.91
Non-vested restricted stock units at September 24, 2011	1,380,927	\$	13.29

**Note 13 Stock-Based Compensation**

We account for all stock-based compensation to employees and directors, including grants of stock options, as stock-based compensation costs in the Condensed Consolidated Financial Statements based on the fair value measured as of the date of grant. These costs are recognized as an expense in the Condensed Consolidated Statements of Operations over the requisite service period and increase additional paid-in capital. The table below shows the stock-based compensation charges included in the Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Stock-based compensation expense included in:				
Cost of revenues	\$ 694	\$ 882	\$ 2,297	\$ 2,847
Research and development	887	1,038	3,099	4,394
Selling, general and administrative	1,758	2,299	4,265	6,130
Restructuring	16	16	16	192
Total stock-based compensation	\$ 3,339	\$ 4,235	\$ 9,661	\$ 13,563

*Stock Options*



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We did not grant any stock options during the three months ended September 24, 2011. During the nine months ended September 24, 2011, we granted 459,750 stock options under the 2002 Plan with a weighted average grant-date fair value of \$4.06 per share. During the three and nine months ended September 25, 2010, 450,000 and 870,570 stock options were granted under the 2002 Plan with weighted average grant-date fair values of \$3.27 and \$4.77 per share, respectively. The following weighted-average assumptions were used in the estimated grant-date fair value calculations for stock options:

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
<b>Stock Options:</b>				
Dividend yield	%	%	%	%
Expected volatility	%	51.1%	50.3%	50.4%
Risk-free interest rate	%	1.38%	1.67%	1.63%
Expected term (in years)		4.61	4.26	4.54

### *Employee Stock Purchase Plan*

During the three and nine months ended September 24, 2011, 158,081 shares and 386,818 shares, respectively, were issued under the Employee Stock Purchase Plan ( ESPP ). During the three and nine months ended September 25, 2010, 207,910 shares and

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365,871 shares, respectively were issued under the ESPP. The following weighted-average assumptions were used in estimating the fair value of employee's purchase rights under the ESPP:

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
<b>ESPP:</b>				
Dividend yield	%	%	%	%
Expected volatility	51.0%	48.6%	53.4%	41.4%
Risk-free interest rate	0.26%	0.20%	0.23%	0.25%
Expected term (in years)	1.0	0.5	0.8	0.5 1.0

### *Unrecognized Compensation Costs*

At September 24, 2011, the unrecognized stock-based compensation, adjusted for estimated forfeitures, was as follows (in thousands):

	Unrecognized Expense	Average Expected Recognition Period in years
Stock options	\$ 9,551	2.33
Restricted stock units	10,534	2.52
Employee Stock Purchase Plan	431	0.35
Total unrecognized stock-based compensation expense	\$ 20,516	

### **Note 14 Net Loss per Share**

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding for the period. Diluted net loss per share is computed giving effect to all potential dilutive common stock, including stock options, restricted stock units and common stock subject to repurchase. Diluted loss per share for the three and nine months ended September 24, 2011 and September 25, 2010, respectively, was based only on the weighted-average number of shares outstanding during that period as the inclusion of any common stock equivalents would have been anti-dilutive.

A reconciliation of the numerator and denominator used in the calculation of basic and diluted net loss per share follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
<b>Numerator:</b>				

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Net loss used in computing basic and diluted net loss per share	\$	(9,904)	\$	(95,827)	\$	(39,006)	\$	(167,875)
<b>Denominator:</b>								
Weighted-average shares used in computing basic net loss per share		50,747		50,431		50,719		50,136
Add potentially dilutive securities								
Weighted average shares used in computing diluted net loss per share		50,747		50,431		50,719		50,136

The following table sets forth the weighted-average of all potentially dilutive securities excluded from the computation in the table above because their effect would have been anti-dilutive (in thousands):

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Options to purchase common stock	4,799	5,255	4,770	5,445
Restricted stock units	1,267	1,527	1,123	578
Employee Stock Purchase Plan	22		43	63
Total potentially dilutive securities	6,088	6,782	5,936	6,086

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**Note 15 Income Taxes**

We recorded an income tax provision of \$0.2 million for the three months ended September 24, 2011 and an income tax benefit of \$2.1 million for the nine months ended September 24, 2011, as compared to an income tax provision of \$0.2 million and \$0.7 million for the three and nine months ended September 25, 2010, respectively. The income tax provision recorded for the three months ended September 24, 2011 reflects the tax provision on our non-U.S. operations in foreign jurisdictions. The income tax benefit recorded for the nine months ended September 24, 2011 primarily relates to a \$2.5 million release of the deferred tax valuation allowance for a non-U.S. jurisdiction, offset by income tax expense in certain of our non-U.S. operations in foreign jurisdictions. The income tax provision for the three and nine months ended September 25, 2010 reflects the tax provision on our non-U.S. operations in foreign jurisdictions. We continue to maintain a valuation allowance for our U.S. Federal and state deferred tax assets.

During the second fiscal quarter ended June 25, 2011, we determined that it is more likely than not that the deferred tax assets of a non-U.S. jurisdiction will be realized after considering all positive and negative evidence. Positive evidence included finalization of our current restructuring activity for the related foreign jurisdiction and conclusion that such location will continue to be in operation for the foreseeable future, as well as a forecast of future taxable income sufficient to realize such deferred tax assets prior to the expiration of existing net operating loss carryforwards due to a change in the entity's structure to a cost-plus arrangement. Accordingly, a deferred tax valuation allowance release of \$2.5 million was recorded as an income tax benefit during the quarter. Our conclusion that it is more likely than not that such deferred tax assets will be realized is strongly influenced by the expectation that such location will continue to be in operation for the foreseeable future. We believe such conclusion is reasonable in light of our current operational structure and forecasted operations, both for the foreign jurisdiction and our consolidated operations; however, such conclusion is inherently uncertain. Therefore, if we have material unforeseen losses or are required to restructure our non-U.S. operations to further align our operating expense structure with our expected revenues, then its ability to generate sufficient income necessary to realize a portion of the deferred tax assets may be reduced and an additional charge to increase the valuation allowance may be recorded.

The liability for uncertain tax positions was classified as a long-term income taxes liability as payments are not anticipated over the next 12 months. It may be reduced when liabilities are settled with taxing authorities or when the statute of limitations expires without assessment from tax authorities. We are unable to make a reasonable estimate as to when cash settlements with the relevant taxing authorities will occur. Unrecognized tax benefits increased by \$1.0 million to \$18.5 million during the nine months ended September 24, 2011 primarily as a result of additional R&D credit reserves and foreign transfer pricing reserves. If recognized, \$14.5 million of these unrecognized tax benefits (net of U.S. Federal benefit) would be recorded as a reduction of future income tax provision before consideration of changes in valuation allowance.

We classify interest and penalties related to uncertain tax positions as part of the income tax provision. For the three and nine months ended September 24, 2011, we recognized interest charges and penalties of approximately \$3,000 and \$26,000, respectively. For the three and nine months ended September 25, 2010, we recognized interest charges and penalties of approximately \$48,000 and \$0.2 million, respectively. As of September 24, 2011 and September 25, 2010, we have accrued total interest and penalties of \$0.5 million and \$0.9 million, respectively, related to unrecognized tax benefits.

The amount of income taxes we pay is subject to ongoing audits by Federal, state and non-U.S. tax authorities which might result in proposed assessments. Our estimate for the potential outcome for any uncertain tax issue is judgmental in nature. A number of years may elapse before an uncertain tax position is audited and finally resolved. While it is often difficult to predict the final outcome or the timing of resolution of any particular uncertain tax position, we believe that our reserves for income taxes reflect the most likely outcome. We adjust these reserves, as well as the related interest, in light of changing facts and circumstances. However, if an ultimate tax assessment exceeds our estimate of tax liabilities, additional tax expense will be recorded. The impact of such adjustments could have a material impact on our results of operations in future periods.

**Note 16 Commitments and Contingencies**

*Environmental Matters*

We are subject to U.S. Federal, state and local, and foreign governmental laws and regulations relating to the protection of the environment, including those governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes, the clean-up of contaminated sites and the maintenance of a safe workplace. We believe that we comply in all material respects with the environmental laws and regulations that apply to us, including those of the California Department of Toxic Substances Control, the Bay Area Air Quality Management District, the City of Livermore Water Resources Division and the California Division of Occupational Safety and Health. We did not receive any notices of violations of environmental laws and regulations in fiscal 2010 or during the first nine months of our fiscal 2011. No provision has been made for loss from environmental remediation liabilities associated with our facilities because we believe that it is not probable that a liability has been incurred as of September 24, 2011.

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While we believe that we are in compliance in all material respects with the environmental laws and regulations that apply to us, in the future, we may receive additional environmental violation notices, and if received, final resolution of the violations identified by these notices could harm our operations, which may adversely impact our operating results and cash flows. New laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination at our or others' sites or the imposition of new cleanup requirements could also harm our operations, thereby adversely impacting our operating results and cash flows.

***Indemnification Arrangements***

We may, from time to time in the ordinary course of our business, enter into contractual arrangements with third parties that include indemnification obligations. Under these contractual arrangements, we have agreed to defend, indemnify and/or hold the third party harmless from and against certain liabilities. These arrangements include indemnities in favor of customers in the event that our wafer probe cards infringe a third party's intellectual property and in favor of our lessors in connection with facility leasehold liabilities that we may cause. In addition, we have entered into indemnification agreements with our directors and certain of our officers, and our bylaws contain indemnification obligations in favor of our directors, officers and agents. These indemnity arrangements may limit the type of the claim, the total amount that we can be required to pay in connection with the indemnification obligation and the time within which an indemnification claim can be made. The duration of the indemnification obligation may vary, and for most arrangements survives the agreement term and is indefinite. We believe that substantially all of our indemnity arrangements provide either for limitations on the maximum amount of potential future payments we could be obligated to make, or limitations on the types of claims and damages we could be obligated to indemnify, or both. However, it is not possible to determine or reasonably estimate the maximum potential amount of future payments under these indemnification obligations due to the varying terms of such obligations, the history of prior indemnification claims, the unique facts and circumstances involved in each particular contractual arrangement and in each potential future claim for indemnification, and the contingency of any potential liabilities upon the occurrence of events that are not reasonably determinable. We have not had any requests for indemnification under these arrangements to date. Our management believes that any liability for these indemnity arrangements would not be material to our accompanying consolidated financial statements. We have not recorded any liabilities for these indemnification arrangements on our Condensed Consolidated Balance Sheet as of September 24, 2011.

***Legal Matters***

From time to time, we may be subject to legal proceedings and claims in the ordinary course of business. For the periods ended September 24, 2011, we were not involved in any material legal proceedings, other than the proceedings summarized below. In the future we may become a party to additional legal proceedings, including proceedings designed to protect our intellectual property rights that require us to spend significant resources. Litigation in general and intellectual property litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict, and the costs incurred in litigation can be substantial, regardless of outcome.

***Customs and Trade Matters***

From time to time we receive communications from certain jurisdictions regarding customs and indirect tax matters such as customs duties and value added taxes. In July 2011 we received an inquiry from a foreign jurisdiction tax authority regarding certain indirect tax matters. We are cooperating with this inquiry, which relates to our prior shipping processes for new product qualifications and for products for certain of our repair center activities. To date, we have accrued \$1.0 million for potential exposure related to this matter, but it is possible that the inquiry could result in additional material liabilities and that we could incur material expenses in responding to the inquiry.

*Patent Litigation*

In 2005, we filed a patent infringement lawsuit in the United States District Court for the District of Oregon against Phicom Corporation, a Korea corporation, and its U.S. subsidiary, both collectively "Phicom", charging that it is willfully infringing four U.S. patents that cover key aspects of our wafer probe cards: U.S. Patent Nos. 5,974,662, 6,246,247, 6,624,648, and 5,994,152. In 2006, we also filed an amended complaint in the same Oregon district court adding two additional patents to the litigation: U.S. Patent Nos. 7,073,254 and 6,615,485. The district court action proceeded in parallel with legal action we brought against Phicom in Korea Courts. The district court action was stayed pending resolution of the complaint that we filed with the United States International Trade Commission, or Commission, on or about November 13, 2007, seeking institution of a formal investigation into the activities of Phicom and of Micronics Japan Co., Ltd. An investigation was initiated and, in November 2009, in response to a request for review of prior decisions by the assigned Administrative Law Judge, the Commission issued a decision, which is termed a "final determination", finding certain of FormFactor's asserted patent claims valid, but not infringed, and other asserted patent claims invalid. The Commission did not find a violation of Section 337 of the Tariff Act of 1930 and terminated the investigation without issuing an exclusionary order against any products. We did not appeal the final determination to the Court of Appeals for the Federal Circuit. The

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stay in the district court action against Phicom, now operating under the name TSC MEMSYS Co. Ltd., was lifted. During our fiscal quarter ending September 24, 2011, we resolved amicably the district court action in Oregon, as well as any continuing infringement proceedings, through a confidential settlement agreement.

In July 2010, we filed a patent infringement lawsuit in the United States District Court for the Northern District of California against Micro-Probe Incorporated charging that it is willfully infringing six U.S. patents that cover aspects of our proprietary technology and wafer probe cards. The complaint sought both injunctive relief and money damages for Micro-Probe's alleged infringement of our U.S. Patent No. 6,441,315 for Contact Structures With Blades Having A Wiping Motion, U.S. Patent No. 6,825,422 for Interconnection Element With Contact Blade, U.S. Patent No. 6,965,244 for High Performance Probe System, U.S. Patent No. 7,227,371 for High Performance Probe System, U.S. Patent No. 6,246,247 for Probe Card Assembly and Kit, and Methods of Using Same, and U.S. Patent No. 6,624,648 for Probe Card Assembly. The complaint also sought injunctive relief and damages against Micro-Probe for unfair competition and further includes claims directed against a former employee for breach of confidence relative to our confidential and propriety information and against the former employee and Micro-Probe for conspiring to breach that confidence. After Micro-Probe and the former employee filed motions to dismiss, we voluntarily filed an amended complaint which was substantially similar to our original complaint except that we added a claim against the former employee alleging misappropriation of trade secrets and we omitted the infringement allegation related to our U.S. Patent No. 6,624,648, which is the subject of a re-examination proceeding before the U.S. Patent and Trademark Office, or USPTO. Micro-Probe and the former employee have both filed answers to our amended complaint. We have filed a second amended complaint in which we added allegations of infringement based upon two additional patents: U.S. Patent No. 7,671,614 for Apparatus and Method for Adjusting An Orientation of Probes and U.S. Patent No. 7,225,538 for Resilient Contact Structures Formed And Then Attached To A Substrate .

One or more third parties have initiated challenges in the U.S. and in foreign patent offices against certain of the above and other of our patents. These actions include requests for re-examination proceedings filed by Micro-Probe with the USPTO directed to our U.S. Patent Nos. 6,246,247, 6,825,422, 6,441,315, 6,965,244, 7,225,538, 7,227,371 and 7,671,614. The USPTO granted the re-examination requests directed to U.S. Patent Nos. 6,246,247, 6,825,422 and 6,441,315, and granted in part the requests directed to U.S. Patent Nos. 6,965,244, 7,227,371 and 7,671,614. The foreign actions include proceedings in Taiwan against several of our Taiwan patents.

Based on the nature and status of our patent-related litigation, no provision has been made because we believe that it is not probable that a liability had been incurred as of September 24, 2011. We will incur material attorneys' fees in prosecuting and defending the various identified actions.

**Note 17 Derivative Financial Instruments**

We operate and sell our products in various global markets. As a result, we are exposed to changes in foreign currency exchange rates. We utilize foreign currency forward contracts to hedge against future movements in foreign exchange rates that affect certain existing foreign currency denominated assets and liabilities, primarily trade receivables and payables. Under this program, our strategy is to have increases or decreases in our foreign currency exposures offset by gains or losses on the foreign currency forward contracts to mitigate the risks and volatility associated with foreign currency transaction gains or losses. We do not use derivative financial instruments for speculative or trading purposes. Our derivative instruments, which are generally settled in the same quarter, are not designated for hedge accounting treatment. We record the fair value of these contracts as of the end of our reporting period to our Condensed Consolidated Balance Sheet with changes in fair value recorded within Other income (expense), net in our Condensed Consolidated Statement of Operations for both realized and unrealized gains and losses.



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As of September 24, 2011, we had the following outstanding foreign exchange forward contracts that we entered into to hedge forecasted revenues and purchases (in thousands):

Currency	Contract Position	Contract Amount (Local Currency)	Contract Amount (U.S. Dollars)
Japanese Yen	Sell	411,366	\$ 5,351
Korean Won	Buy	(30,512)	(1,009)
Taiwan Dollar	Buy	(366,071)	(312)
Total USD notional amount of outstanding foreign exchange contracts			\$ 4,030

The contracts were entered into on September 23, 2011 and matured on September 27, 2011. Our foreign currency contracts are classified within Level 2 of the fair value hierarchy as they are valued using pricing models that utilize observable market inputs. There was no change in the value of these contracts as of September 24, 2011. Additionally, no gains or losses relating to the outstanding derivative contracts were recorded in the three and nine months ended September 24, 2011.

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The location and amount of gains and losses related to non-designated derivative instruments that matured in the three and nine months ended September 24, 2011 and September 25, 2010 in the Condensed Consolidated Statement of Operations are as follows (in thousands):

Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized on Derivatives	Amount of Gain or (Loss) Recognized on Derivatives			
		Three Months Ended		Nine Months Ended	
		September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Foreign exchange forward contracts	Other income (expense), net	\$ (352)	\$ (1,100)	\$ (641)	\$ (1,539)

### **Note 18 Subsequent Events**

In October 2011, we entered into a Separation Agreement and General Release with a former Senior Vice President. As a result, we will record a charge of \$0.8 million within Cost of revenues in the Condensed Consolidated Statement of Operations for the fiscal quarter and year ending December 31, 2011, such charge being composed of \$0.5 million of payroll and related expenses and \$0.3 million of stock-based compensation expense related to the modification of certain stock-based compensation awards.

### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **Cautionary Statement Regarding Forward-Looking Statements**

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the Securities Exchange Act of 1934 and the Securities Act of 1933, which are subject to risks, uncertainties and assumptions that are difficult to predict. The forward-looking statements include statements concerning, among other things, our business strategy, including anticipated trends and developments in and management plans for our business and the markets in which we operate, financial results, operating results, revenues, gross margin, operating expenses, products, projected costs and capital expenditures, research and development programs, sales and marketing initiatives, and competition. In some cases, you can identify these statements by forward-looking words such as may, might, could, should, expect, plan, anticipate, estimate, predict, intend and continue, the negative or plural of these words and other comparable terminology.

The forward-looking statements are only predictions based on our current expectations and our projections about future events. All forward-looking statements included in this Quarterly Report on Form 10-Q are based upon information available to us as of the filing date of this Quarterly Report on Form 10-Q. You should not place undue reliance on these forward-looking statements. We undertake no obligation to update any of these statements for any reason. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from those expressed or implied by these statements. These factors include the matters discussed in the section titled Risk Factors in our Annual Report on Form 10-K for the year ended December 25, 2010 and in the section titled Risk Factors and elsewhere in this Quarterly Report on Form 10-Q. You should carefully consider the numerous risks and uncertainties described under these sections.

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The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the accompanying notes contained in this Quarterly Report on Form 10-Q. Unless expressly stated or the context otherwise requires, the terms we, our, us and FormFactor refer to FormFactor, Inc. and its subsidiaries.

### Overview

We design, develop, manufacture, sell and support precision, high performance advanced semiconductor wafer probe card products and solutions. Semiconductor manufacturers use our wafer probe cards to perform wafer sort and test on the semiconductor die, or chips, on the whole semiconductor wafer, which is prior to singulation of the wafer into individual separate chips. We work closely with our customers on product design, as each wafer probe card is a custom product that is specific to the chip and wafer designs of the customer and to certain other semiconductor test equipment used by the customer. During wafer sort and test, a wafer probe card is mounted on a prober and connected to a semiconductor tester. The wafer probe card is used as an interface to connect electrically with and test individual chips on a wafer. Our wafer probe cards are used by our customers in the front end of the semiconductor manufacturing process, as are our image sensor and parametric probe cards. We operate in a single industry segment and have derived substantially all of our revenues from the sale of wafer probe cards incorporating our proprietary technology, including our MicroSpring® interconnect technology and our ATRE™ wafer test technology.

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During the nine months ended September 24, 2011, we saw revenue decline over the same period in fiscal 2010 across our DRAM and Flash product markets. Our revenues decreased by 3.8%, or \$5.5 million, in the nine months ended September 24, 2011 as compared to the same period in fiscal 2010, but increased by 10.1%, or \$4.8 million, in the three months ended September 24, 2011 as compared to the same period in fiscal 2010. The decline in the nine month period is attributed primarily to lost business opportunities due to an extended qualification period for our SmartMatrix platform at certain customers, as well as changing order patterns for our NAND Flash products. However, this revenue decline was partially offset by overall demand increases in our SOC product. The increase in revenues for the three month period is attributed to increased sales of our SmartMatrix product family as we continue to qualify certain customers. This increase was partially offset by reduced demand for our NAND Flash products.

We incurred a net loss of \$9.9 million in the third quarter of fiscal 2011 as compared to a net loss of \$95.8 million for the third quarter of fiscal 2010. The reduction in net loss quarter over quarter is primarily attributable to the enterprise-wide impairment of \$52.0 million recorded in the third quarter of fiscal 2010, as well as a reduction in depreciation resulting from this enterprise-wide impairment. Net loss also decreased quarter over quarter due to the restructuring actions undertaken throughout 2010, the purpose of which was to simplify our overall structure and better align our operations with the current business environment, streamline our manufacturing structure and reduce both manufacturing cost and cycle times. The net loss for the third quarter of fiscal 2011 includes restructuring charges of \$0.3 million and impairment charges of \$0.1 million. The net loss for the third quarter of fiscal 2010 included \$8.5 million of restructuring charges and total impairment charges for certain long-lived assets of \$55.4 million.

We incurred a net loss of \$39.0 million for the first nine months of fiscal 2011 as compared to \$167.9 million in the first nine months of fiscal 2010. The reduction in net loss period over period is primarily attributable to the factors discussed above with respect to the net loss reduction for the nine months ended September 24, 2011 as compared to the same period of fiscal 2010.

Our cash, cash equivalents and marketable securities totaled approximately \$316.0 million as of September 24, 2011, as compared to \$347.2 million at December 25, 2010. While there are no specific significant transactions or arrangements that are likely to materially affect liquidity, economic uncertainty and weak credit markets are driving our customers to delay procurement and payment decisions which may adversely impact our cash collections. We believe that we will be able to satisfy our working capital requirements for the next twelve months with the liquidity provided by our existing cash, cash equivalents and marketable securities. If we are unsuccessful in improving our operating efficiency, reducing our cash outlays or increasing our available cash through financing, our cash, cash equivalents and marketable securities will further decline in fourth quarter of fiscal 2011 and in future fiscal quarters.

We believe the following information is important to understanding our business, our financial statements and the remainder of this discussion and analysis of our financial condition and results of operations:

*Revenues.* We derive substantially all of our revenues from product sales of wafer probe cards. Revenues from our customers are subject to fluctuations due to factors including, but not limited to, design cycles, technology adoption rates, competitive pressure to reduce prices, cyclical nature of the different end markets into which our customers' products are sold and market conditions in the semiconductor industry. Historically, increases in revenues have resulted from increased demand for our existing products, the introduction of new, more complex products and the penetration of new markets. We expect that revenues from the sale of wafer probe cards will continue to account for substantially all of our revenues for the foreseeable future.

*Cost of Revenues.* Cost of revenues consists primarily of manufacturing materials, payroll, shipping and handling costs and manufacturing-related overhead. Our manufacturing operations rely upon a limited number of suppliers to provide key components and

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materials for our products, some of which are a sole source. We order materials and supplies based on backlog and forecasted customer orders. Tooling and setup costs related to changing manufacturing lots at our suppliers are also included in the cost of revenues. We expense all warranty costs and inventory provisions as cost of revenues.

We design, manufacture and sell custom advanced wafer probe cards into the semiconductor test market, which is subject to significant variability and demand fluctuations. Our wafer probe cards are complex products that are custom to a specific chip design of a customer and must be delivered on relatively short lead-times as compared to our overall manufacturing process. As our advanced wafer probe cards are manufactured in low volumes and must be delivered on relatively short lead-times, it is not uncommon for us to acquire production materials and start certain production activities based on estimated production yields and forecasted demand prior to or in excess of actual demand for our wafer probe cards. We record an adjustment to our inventory valuation for estimated obsolete and non-saleable inventories based on assumptions about future demand, changes to manufacturing processes and overall market conditions.

*Research and Development.* Research and development expenses include expenses related to product development, engineering and material costs. Almost all research and development costs are expensed as incurred. We plan to continue to invest in research and development activities to improve and enhance existing technologies and to develop new technologies for current and new markets and for new applications.

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*Selling, General and Administrative.* Selling, general and administrative expenses include expenses related to sales, marketing, and administrative personnel, provision for doubtful accounts, internal and outside sales representatives' commissions, market research and consulting, and other sales, marketing, and administrative activities. These expenses also include costs for protecting and enforcing our patent rights and regulatory compliance costs.

*Restructuring Charges.* Restructuring charges include costs related to employee termination benefits and cost of long-lived assets abandoned or impaired, as well as contract termination costs.

*Impairment of Long-lived Assets.* Asset impairment charges include charges associated with the write down of assets that have no future expected benefit or assets for which circumstances indicate that the carrying amount of these assets may not be recoverable, as well as adjustments to the carrying amount of our assets held for sale.

*Use of Estimates.* The preparation of consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Estimates may change as new information is obtained. Significant items that are subject to such estimates include the fair value of revenue elements, fair value of marketable securities, allowance for doubtful accounts, reserves for product warranty, valuation of obsolete and slow moving inventory, valuation of our long-lived assets, the assessment of recoverability of long-lived assets, valuation and recognition of stock-based compensation, provision for income taxes and valuation allowance for deferred tax assets and tax liabilities and accruals for other liabilities.

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The following table sets forth our operating results as a percentage of revenues for the periods indicated:

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	77.0	115.2	81.4	103.9
Gross profit (loss)	23.0	(15.2)	18.6	(3.9)
Operating expenses:				
Research and development	20.0	27.1	23.6	30.4
Selling, general and administrative	21.5	34.3	25.0	36.5
Restructuring charges, net	0.5	18.0	0.1	10.1
Impairment of long-lived assets	0.2	117.0	0.3	39.0
Total operating expenses	42.2	196.4	49.0	116.0
Operating loss	(19.2)	(211.6)	(30.4)	(119.9)
Interest income, net	0.6	1.3	0.8	1.5
Other income (expense), net	(0.1)	8.4	0.1	2.8
Loss before income taxes	(18.7)	(201.9)	(29.5)	(115.6)
Provision for (benefit from) income taxes	0.3	0.5	(1.5)	0.5
Net loss	(19.0)%	(202.4)%	(28.0)%	(116.1)%

*Three and nine months ended September 24, 2011 and September 25, 2010:*

**Revenues**

	Three Months Ended			Nine Months Ended		
	September 24, 2011	September 25, 2010	% Change	September 24, 2011	September 25, 2010	% Change
(In thousands, except percentages)						
Revenues by Market:						
DRAM	\$ 36,496	\$ 30,069	21.4%	\$ 97,295	\$ 104,227	(6.7)%
Flash	7,329	9,026	(18.8)	18,789	20,920	(10.2)
SOC	8,290	8,252	0.5	23,017	19,506	18.0
Total revenues	\$ 52,115	\$ 47,347	10.1%	\$ 139,101	\$ 144,653	(3.8)%

Revenues for the three months ended September 24, 2011 increased 10.1%, or \$4.8 million, while revenues for the nine months ended September 24, 2011 decreased 3.8%, or \$5.5 million, compared to the revenues of the comparable periods of the prior year. The three month comparable increase is primarily due to increased volume of shipments of advanced wafer probe cards for the DRAM memory market segment. The nine month comparable decrease is primarily associated with lower DRAM and Flash sales in our second fiscal quarter.

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Our revenues for the three and nine months ended September 24, 2011 were primarily generated by sales of wafer probe cards to manufacturers of DRAM devices. DRAM sales were higher in the three months ended September 24, 2011 as compared to the same period in the prior year primarily due to increased volumes of SmartMatrix products purchased by certain customers and platform qualifications at certain customers in the second fiscal quarter of 2011. Despite a 21% increase in DRAM sales in the comparable three month period, revenues for the nine months ended September 24, 2011 were 7% lower than the comparable period, as extended qualification periods for the SmartMatrix product family led to reduced revenues in the second fiscal quarter of 2011.

Revenues from sales to Flash memory device manufacturers decreased in the three and nine months ended September 24, 2011 compared to the same periods in the prior year. The decrease was driven primarily by a significant decrease in the sale of NAND Flash wafer probe cards related to the timing of customer orders and a reduction in short-term demand with certain of our customers.

Revenues from sales to SOC device manufacturers were flat for the three months ended September 24, 2011 compared to the previous year. Revenues from sales to SOC device manufacturers increased in the nine months ended September 24, 2011 compared to the same periods in the prior year, primarily due to the growth in the overall SOC device market and continued market trends in favor of more complex devices and the higher parallelism offered by SOC devices, which positively impacted revenues from sales of our wafer probe cards in this market.



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#### *Revenues by Geographic Region*

The following table sets forth our revenues by geographic region for the periods indicated:

	Three Months Ended		September 25,		September 24,		Nine Months Ended		September 25,	
	September 24, 2011	% of Revenue	September 25, 2010	% of Revenue	September 24, 2011	% of Revenue	September 25, 2010	% of Revenue	September 25, 2010	% of Revenue
(In thousands, except percentages)										
Taiwan	\$ 9,883	18.9%	\$ 17,812	37.6%	\$ 44,251	31.8%	\$ 54,838	37.9%		
Japan	11,664	22.4	7,655	16.2	24,881	17.9	24,496	16.9		
North America	7,033	13.5	7,889	16.6	20,388	14.7	27,900	19.3		
South Korea	16,767	32.2	7,663	16.2	33,385	24.0	19,103	13.2		
Asia Pacific										
(1)	5,153	9.9	4,777	10.1	11,009	7.9	12,110	8.4		
Europe	1,615	3.1	1,551	3.3	5,187	3.7	6,206	4.3		
Total revenues	\$ 52,115	100.0%	\$ 47,347	100.0%	\$ 139,101	100.0%	\$ 144,653	100.0%		

(1) Asia-Pacific includes all countries in the region except Taiwan, Japan and South Korea, which are disclosed separately.

Geographic revenues information is based on the location to which we ship the customer product. For example, if a certain South Korean customer purchases through their North American subsidiary and requests the products to be shipped to an address in Asia-Pacific, this sale will be reflected in the revenues for Asia-Pacific rather than North America.

The increase in South Korea revenues for the three and nine months ended September 24, 2011 compared to the same periods in the prior year was primarily due to the industry ramp up of DDR3 and Low Power DDR2, increased market penetration of our SOC products to customers in this region, and the continued market adoption and ramp of our SmartMatrix and TouchMatrix products across both the DRAM and Flash markets. The significant decrease in North America was primarily driven by a decrease in Flash shipments to that region. Revenues in Europe and Asia Pacific were relatively flat for the comparable time periods, while the decrease in revenue in Taiwan was driven by a decrease in DRAM and Flash shipments to that region, partially offset by an increase in SOC revenue related to a recently qualified customer. Increased Japan revenues in the three month comparable period were the result of increased SmartMatrix sales to the region.

The following customers accounted for more than 10% of our revenues for the periods indicated:

	Three Months Ended		September 25,		September 24,		September 25,	
	September 24, 2011	September 25, 2010	September 25, 2010	% of Revenue	September 24, 2011	% of Revenue	September 25, 2010	% of Revenue
Elpida Memory (1)	21.5%	21.6%			18.2%		21.6%	
Samsung (2)	14.2	17.3			11.8		14.0	
Hynix Semiconductor (3)	24.5	10.5			16.3		12.7	

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- (1) Includes Elpida Memory and its consolidated subsidiaries, Rexchip Electronics Corporation and Tera Probe, Inc.
- (2) Includes Samsung Semiconductor, Inc. and its consolidated subsidiary Samsung Austin Semiconductor.
- (3) Includes Hynix Semiconductor and its consolidated subsidiary Hynix-Numonyx Semiconductor.

The percentages above reflect customer constellations as of September 24, 2011. Prior period concentrations have been updated to reflect the current customer compositions.

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#### *Gross Profit (Loss)*

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Gross profit (loss)	\$ 11,974	\$ (7,194)	\$ 25,933	\$ (5,591)
% of revenues	23.0%	(15.2)%	18.6%	(3.9)%

Gross margin fluctuates with revenue levels, product mix, selling prices, factory loading, and material costs. For the three and nine months ended September 24, 2011, gross margin increased compared to the same period in the prior year, primarily due to favorable changes in product mix due to higher margin products, reductions in inventory provision charges, higher production yield, lower depreciation expense and reductions in general overhead costs.

The increase in gross margin for the three and nine months ended September 24, 2011 compared to the same fiscal 2010 periods was driven by \$4.9 million and \$6.6 million, respectively, of lower inventory provision charges, excluding a \$4.7 million favorable impact for the revaluation of previously reserved materials in the three months ended June 26, 2010. These improvements are the result of current and on-going initiatives to improve materials planning and procurement processes that resulted in reductions of our excess inventory levels. The value of previously reserved materials that were used in manufacturing and shipped during the three and nine months ended September 24, 2011 was \$0.4 million and \$1.8 million, respectively. The increase in gross margin also included \$3.3 million and \$10.4 million, respectively, of lower depreciation expense resulting primarily from the fiscal 2010 enterprise-wide impairment and our decision to cease manufacturing operations in Singapore and Korea, as well as a reduction of \$1.6 million and \$6.0 million, respectively, in general overhead resulting from our cost control initiatives. In addition, we experienced certain favorable changes in product mix from lower margin to higher margin products.

Gross margin included stock-based compensation of \$0.7 million and \$2.3 million for the three and nine months ended September 24, 2011, respectively, compared to \$0.9 million and \$2.8 million for the three and nine months ended September 25, 2010, respectively, with the decrease being primarily due to the decrease in headcount, partially offset by expense related to current year grants.

In the future, our gross margins may be adversely impacted by lower levels of product revenues despite reductions in our operating cost structure. Our gross margins may also be adversely affected if, amongst other things, we are required to record additional inventory provision charges and inventory write-downs should estimated average selling prices of products held in finished goods inventories fall below the manufacturing cost of those products.

#### *Research and Development*

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Research and development	\$ 10,423	\$ 12,825	\$ 32,861	\$ 43,913
% of revenues	20.0%	27.1%	23.6%	30.4%

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Research and development expenses for the three and nine months ended September 24, 2011 decreased compared to the same periods in the prior year due to the combined effect of the decrease in certain new technology product development related costs and the decrease in other costs as a result of our cost reduction efforts. As a percent of revenues, research and development expenses decreased during the three and nine months ended September 24, 2011 compared to the three and nine months ended September 25, 2010 due to our cost reduction efforts.

In the three and nine months ended September 24, 2011, costs related to our research and development activities decreased by approximately \$2.4 million and \$11.1 million, respectively, from the comparable periods of fiscal 2010 resulting primarily from reduced payroll and related costs of \$1.6 million and \$5.3 million, respectively, driven by reduced headcount, and reduced materials and related costs of \$0.4 million and \$1.9 million, respectively. We also had a decrease in depreciation and facilities related costs of \$0.2 million and \$1.4 million, respectively, resulting primarily from the fiscal 2010 enterprise-wide impairment as well as the reduction of our facilities footprint during 2010. Stock-based compensation included within research and development expense was \$0.9 million and \$3.1 million for the three and nine months ended September 24, 2011 compared to \$1.0 million and \$4.4 million for

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the three and nine months ended September 25, 2010, with the decrease being primarily due to the decrease in headcount, partially offset by expense related to current year grants.

We are continuing our strategic investments in research and development, including investments in the development of our next generation parallelism architecture and products, fine pitch, advanced MicroSpring interconnect technology, ATRE wafer test technology and new process technologies. We remain committed to product development in new and emerging technologies.

***Selling, General and Administrative***

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Selling, general and administrative	\$ 11,200	\$ 16,219	\$ 34,741	\$ 52,810
% of revenues	21.5%	34.3%	25.0%	36.5%

Selling, general and administrative expenses for the three and nine months ended September 24, 2011 decreased \$5.0 million and \$18.1 million, respectively, from the comparable periods of the prior year primarily due to a decrease in personnel-related costs and other discretionary spending. As a percent of revenue, selling, general and administrative expenses decreased during the three and nine months ended September 24, 2011 as compared to the comparable periods of the prior year, primarily due to the reduction of expenses discussed below.

In the three and nine months ended September 24, 2011, salary and payroll related costs, for selling, general and administrative functions, including incentive bonuses, decreased by \$2.0 million and \$7.2 million, respectively, from the comparable periods of fiscal 2010 due to reduced headcount and a reduction in incentive bonus. In addition, we experienced decreased depreciation expense resulting from the enterprise-wide impairment recorded during fiscal 2010 of \$0.7 million and \$2.2 million, respectively, as well as a reduction in facilities related costs of \$0.7 million and \$2.7 million during the three and nine months ended September 24, 2011 compared with the same periods of fiscal 2010 resulting from the reduction of our facilities footprint during 2010. Furthermore, our cost reduction efforts, as well as reduction in on-going legal activities, resulted in a reduction in legal and outside service fees of \$0.9 million and \$2.3 million during the three and nine months ended September 24, 2011 compared with the same periods of fiscal 2010. Stock-based compensation expenses included within selling, general and administrative expense were \$1.8 million and \$4.3 million for the three and nine months ended September 24, 2011 compared to \$2.3 million and \$6.1 million for the comparable periods of the prior year. The decrease in stock-based compensation was primarily due to reduced headcount, partially offset by expense related to current year grants.

***Restructuring Charges, net***

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Restructuring charges, net	\$ 258	\$ 8,539	\$ 197	\$ 14,603

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% of revenues	0.5%	18.0%	0.1%	10.1%
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For the three and nine months ended September 24, 2011, restructuring charges decreased \$8.3 million and \$14.4 million, respectively, from the comparable periods of the prior year. The restructuring plans impacting the first and second quarters of fiscal 2011 and 2010 are discussed below.

### *2011 Restructuring Activities*

In the first quarter of fiscal 2011, we implemented a restructuring plan (the Q1 2011 Restructuring Plan ) which resulted in the reduction of our global workforce by 13 full-time employees across the organization. We recorded \$1.1 million in charges for severance and related benefits during the quarter related to this plan. The activities comprising this reduction in workforce were substantially completed by the end of the second quarter of fiscal 2011. As a result of the Q1 2011 Restructuring Plan, we have realized, and expect to continue to realize, quarterly savings, excluding stock-based compensation expenses, of approximately \$0.6 million in subsequent quarters.

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In the second quarter of fiscal 2011, we implemented a restructuring plan (the Q2 2011 Restructuring Plan ) which resulted in the reduction of our global workforce by 13 full-time employees across the organization. We recorded \$0.6 million in charges for severance and related benefits during the quarter related to this plan.

The activities comprising this reduction in workforce were substantially completed by the end of the third quarter of fiscal 2011. As a result of the Q2 2011 Restructuring Plan we have realized, and expect to continue to realize, quarterly savings, excluding stock-based compensation expenses, of approximately \$0.4 million in subsequent quarters.

Additionally, in the second quarter of fiscal 2011 we executed an amendment to the existing lease arrangement for our facility in Singapore which released us from our obligations related to the floor previously utilized for manufacturing in this facility. We were also granted a rent reduction for the remaining occupied facilities in this building. We had previously recorded certain asset retirement obligations and accruals related to our ceasing use of these facilities in connection with a prior restructuring action. As a result, our Condensed Consolidated Statement of Operations for the nine months ended September 24, 2011 includes a benefit of \$1.5 million recorded to Restructuring charges, net .

In the third quarter of fiscal 2011, we implemented a restructuring plan (the Q3 2011 Restructuring Plan ) which resulted in the reduction of our global workforce by four full-time employees primarily in our procurement and logistics organizations. We recorded \$0.3 million in charges for severance and related benefits during the quarter related to this plan. As a result of the Q3 2011 Restructuring Plan, we expect to realize quarterly savings, excluding stock-based compensation expenses, of approximately \$0.2 million in subsequent quarters.

The liabilities we have accrued represent our best estimate of the obligations we expect to incur and could be subject to adjustment as market conditions change. The remaining cash payments associated with our various reductions in workforce are expected to be paid by the end of the fourth quarter of fiscal 2011.

*2010 Restructuring Activities*

We recorded \$29,000 and \$3.6 million in restructuring charges in the three and nine months ended September 25, 2010, respectively, as part of our then-current regionalization strategy (the Q1 2010 Restructuring Plan ). These charges consisted of termination benefits related to reductions in work force of 106 full-time positions, which were all related to severance and related benefits. Subsequently, in the second quarter of fiscal 2010 we undertook a plan to rescind the previously issued severance arrangements for certain employees impacted by this plan, resulting in the reversal of \$3.3 million of the accrual for severance costs booked in conjunction with the Q1 2010 Restructuring Plan, including the accrued retention bonus to date.

In the second quarter of fiscal 2010, we announced a series of corporate initiatives, including a reduction in workforce, which represented a renewed focus on streamlining and simplifying our operations as well as reducing our quarterly operating costs (the Q2 2010 Restructuring Plan ). These actions included a reduction in workforce impacting 67 employees spread across all functions of the organization, as well as a reduction in the scope of the previously contemplated manufacturing operations in Korea, resulting in a reduction of workforce of 16 employees related to the assembly and test function. We recorded \$4.9 million and \$0.2 million in charges for the Q2 2010 Restructuring Plan in the second and third quarter of fiscal 2010, respectively, primarily for severance and related benefits. Additionally, in conjunction with the Q2 2010 Restructuring Plan we identified certain equipment and software assets related to our assembly and test operations in Korea that would no longer

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be utilized. As a result, we recorded impairment charges of approximately \$0.9 million and \$85,000 in the second and third quarters of fiscal 2010, respectively, representing the net book value of these assets.

In the third quarter of fiscal 2010, we announced a restructuring plan (the Q3 2010 Restructuring Plan ) to cease the transition of manufacturing operations to Singapore. This decision resulted in a reduction in force of 58 employees at our Singapore facility. The manufacturing activities that were scheduled to be transitioned to Singapore remained in Livermore, and Livermore continued as the primary manufacturing operating location for the Company. In conjunction with the Q3 2010 Restructuring Plan, we also undertook a reduction in force of two additional individuals in our Livermore operations.

In conjunction with the Q3 2010 Restructuring Plan, we recorded charges of \$1.0 million for severance and related benefits and impairment charges of \$7.6 million for certain equipment and leasehold improvements in Singapore that would no longer be utilized. In addition, due to the combined effect of the significant change in our business strategy in connection with the Q3 2010 Restructuring Plan, recurring operating losses and the sustained decline in the Company's stock price, we reviewed the recoverability of our long-lived assets in the third quarter of fiscal 2010, as discussed in Note 10.



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The activities comprising the above reductions in force were substantially completed by the end of the first quarter of fiscal 2011.

***Impairment of Long-lived Assets***

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Impairment of long-lived assets	\$ 100	\$ 55,402	\$ 451	\$ 56,401
% of revenues	0.2%	117.0%	0.3%	39.0%

During the first quarter of 2011 we recorded an impairment charge of \$0.4 million related to the termination of aspects of an on-going project related to certain software development for internal use that had been recorded in construction-in-progress. Additionally, during the three months ended September 24, 2011, we recorded an impairment of \$0.1 million related to the termination of additional on-going projects that had been recorded in construction-in-progress.

For the three and nine months ended September 25, 2010, we recorded impairment charges of \$55.4 million and \$56.4 million, respectively. The impairment charges resulted primarily from the enterprise-wide asset impairment analysis performed during the third fiscal quarter of 2010, as well as the change in strategy in the second quarter of fiscal 2010 to align our operations with the then-current business environment and streamline our manufacturing structure.

In the second quarter of fiscal 2010, we recorded an impairment charge of \$1.0 million related to the termination of an on-going construction-in-progress project. In the third quarter of fiscal 2010, we recorded impairment charges totaling \$3.4 million as follows:

- \$1.7 million impairment related to certain construction-in-progress projects for the development and build of manufacturing equipment, including additional related equipment that was in-service, that was identified as excess capacity;
- \$1.1 million impairment of certain purchased intangible assets related to precision motion control automation that were acquired in conjunction with our acquisition of certain assets from Electroglas, Inc. in 2009;
- \$0.5 million related to certain leasehold improvements and furniture and fixtures that were to be abandoned as a result of the consolidation of office space in Livermore; and
- \$0.1 million write down of a building held for sale to its estimated fair value.

In addition, we performed a recoverability test on our long-lived assets during the quarter ended September 25, 2010 due to a significant change in our business strategy in connection with the Q3 2010 Restructuring Plan, recurring operating losses and net cash outflows from operations and the sustained decline in the Company's stock price. As a result of this test, we concluded that our business was not able to fully recover the

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carrying amounts of our assets. Accordingly, we tested the carrying amounts at September 25, 2010 of all of its long-lived assets for impairment. Based on this analysis, an impairment charge of approximately \$52.0 million was recorded as of September 25, 2010. This charge was composed of \$27.7 million for leasehold improvements, \$11.2 million for manufacturing equipment, \$8.5 million for computer equipment, \$4.4 million for construction-in-progress and \$0.2 million for purchased intangible assets.

Management believes it is reasonably possible that additional impairment charges that would reduce further the carrying amounts of our property and equipment and intangible assets may arise in the remainder of 2011 if we are unable to achieve the operating results anticipated by our 2011 financial plan.

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

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Interest income, net	\$ 335	\$ 623	\$ 1,128	\$ 2,120
% of revenue	0.6%	1.3%	0.8%	1.5%
Other income (expense), net	\$ (75)	\$ 3,960	\$ 135	\$ 3,995
% of revenues	(0.1)%	8.4%	0.1%	2.8%

The decrease in interest income from cash, cash equivalents and marketable securities for the three and nine months ended September 24, 2011 as compared with the same periods of the prior year was primarily related to lower average balances. Cash, cash equivalents, restricted cash and marketable securities were \$316.3 million at September 24, 2011 compared to \$372.2 million at September 25, 2010. Weighted average yields for the three months ended September 24, 2011 and September 25, 2010 were 0.41% and 0.78%, respectively, and the weighted average yields for the nine months ended September 24, 2011 and September 25, 2010 were 0.47% and 0.75%, respectively. The decrease in yields was primarily attributable to the maturity of higher yielding securities and subsequent reinvestment to shorter term, lower yielding securities.

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Other income (expense), net for the three months ended September 24, 2011 was mainly composed of foreign currency losses primarily related to Korean Won and Japanese Yen. Other income (expense), net for the nine months ended September 24, 2011 included payments received from an intellectual property settlement as well as foreign currency losses primarily related to Korean Won and Japanese Yen. Other income (expense), net for the three and nine months ended September 25, 2010 was mainly composed of income from the sale of component supplies and net realized gains related to the sale of investments offset by foreign currency losses primarily related to Korean Won and Japanese Yen.

**Provision For (Benefit From) Income Taxes**

	Three Months Ended		Nine Months Ended	
	September 24, 2011	September 25, 2010	September 24, 2011	September 25, 2010
	(In thousands, except percentages)			
Provision for (benefit from) income taxes	\$ 157	\$ 231	\$ (2,048)	\$ 672
Effective tax rate	1.6%	0.2%	5.0%	0.4%

We recorded an income tax provision of \$0.2 million and an income tax benefit of \$2.1 million for the three months and nine months ended September 24, 2011, respectively, and an income tax provision of \$0.2 million and \$0.7 million for the three and nine months ended September 25, 2010, respectively. The income tax provision recorded for the three months ended September 24, 2011 reflects the tax provision on our non-U.S. operations in foreign jurisdictions. The income tax benefit recorded for the nine months ended September 24, 2011 primarily relates to a \$2.5 million release of the deferred tax valuation allowance for a non-U.S. jurisdiction, offset by income tax expense in certain of our non-U.S. operations in foreign jurisdictions. The income tax provision recorded for the three and nine months ended September 25, 2010 primarily related to on our non-U.S. operations.

During the quarter ended September 24, 2011, we determined that it is more likely than not that the deferred tax assets of a non-U.S. jurisdiction will be realized after considering all positive and negative evidence. Positive evidence included finalization of our current restructuring activity for the related foreign jurisdiction and conclusion that such location will continue to be in operation for the foreseeable future, as well as a forecast of future taxable income sufficient to realize such deferred tax assets prior to the expiration of existing net operating loss carry-forwards due to a change in the entity's structure to a cost-plus arrangement. Accordingly, a deferred tax valuation allowance release of \$2.5 million was recorded as an income tax benefit during the quarter. Our conclusion that it is more likely than not that such deferred tax assets will be realized is strongly influenced by the expectation that such location will continue to be in operation for the foreseeable future. We believe such conclusion is reasonable in light of our current operational structure and forecasted operations, both for the foreign jurisdiction and our consolidated operations; however, such conclusion is inherently uncertain. Therefore, if we have material unforeseen losses or are required to restructure our non-U.S. operations to further align our operating expense structure with our expected revenues, then its ability to generate sufficient income necessary to realize a portion of the deferred tax assets may be reduced and an additional charge to increase the valuation allowance may be recorded.

We recognize interest charges and penalties related to uncertain tax positions as part of the income tax provision. For the three and nine months ended September 24, 2011 we recognized interest charges and penalties of \$3,000 and \$26,000, respectively. For the three and nine months ended September 25, 2010, we recognized interest charges of \$48,000 and \$0.2 million, respectively. We have not recognized any penalties in any of the periods presented. As of September 24, 2011 and September 25, 2010, we have accrued total interest charges and penalties of \$0.5 million and \$0.9 million, respectively, related to the unrecognized tax benefits.

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We anticipate that we will continue to record a valuation allowance against our U.S. deferred tax assets. We expect our future tax provisions, during the time such valuation allowances are recorded, will consist primarily of the tax provision of our profitable non-U.S. jurisdictions.

Our effective tax rate may vary from period to period based on changes in estimated taxable income or loss by jurisdiction, changes to the valuation allowance, changes to U.S. Federal, state or foreign tax laws, future expansion into areas with varying country, state, and local income tax rates, deductibility of certain costs and expenses by jurisdiction.

Table of Contents**Liquidity and Capital Resources**

	September 24, 2011	December 25, 2010
	(In thousands)	
Working capital	\$ 339,125	\$ 370,767
Cash, cash equivalents and marketable securities	\$ 316,032	\$ 347,235

**Working capital:** The decrease in working capital in the nine months ended September 24, 2011 was primarily due to the use of cash from operating activities and reductions in accrued liabilities driven by the timing of payments, reductions in payroll and incentive compensation amounts, and income taxes paid in various foreign tax jurisdictions, offset by decreased prepaid expenses due primarily to cost control efforts.

**Cash, cash equivalents and marketable securities:** Cash and cash equivalents consist of deposits held at major banks, money market funds and U.S. government securities that at the time of purchase had maturities of 90 days or less. Marketable securities consist of U.S. government agency securities and commercial paper. We typically invest in highly-rated securities with low probabilities of default. Our investment policy requires investments to be rated single-A or better, limits the types of acceptable investments, concentration as to security holder and duration of the investment. Cash, cash equivalents and marketable securities include \$11.2 million held by our foreign subsidiaries as of September 24, 2011.

**Days Sales Outstanding:** Days sales outstanding from receivables ( DSO ) were 49 days at September 24, 2011, compared with 66 days at December 25, 2010. The decrease in DSO is primarily due to continued improvement in our collection efforts as well as the shift in sales to customers with shorter payment terms.

**Summary cash flows:**

	Nine Months Ended	
	September 24, 2011	September 25, 2010
	(In thousands)	
Cash used in operating activities	\$ (21,773)	\$ (58,282)
Cash provided by investing activities	46,309	51,782
Cash (used in) provided by financing activities	(5,024)	3,635

**Cash flows from operating activities:** Net cash used in operating activities for the nine months ended September 24, 2011 was primarily driven by the net loss of \$39.0 million, offset in part by \$19.0 million of non-cash charges consisting primarily of \$8.6 million of depreciation and amortization, \$9.7 million of stock-based compensation and \$4.9 million of provision for excess and obsolete inventories. The net change in operating assets and liabilities of \$1.8 million for the nine months ended September 24, 2011 consisted primarily of a decrease of \$9.4 million in accrued liabilities, primarily those related to payroll and bonus, as well as income taxes paid in various foreign tax jurisdictions. This use of cash was partially offset by an increase in accounts payable driven by the timing of our payments to vendors, a decrease in other assets related to the receipt of certain long-term refundable income tax amounts and a \$2.5 million reduction in prepaid expenses and other current assets primarily due to the collection of certain amounts received in relation to the liquidation of Electroglas as part of the finalization of its bankruptcy proceedings.

Net cash used in operating activities for the nine months ended September 25, 2010 was primarily driven by the net loss of \$167.9 million incurred during the first nine months of fiscal 2010 offset in part by \$106.3 million of non-cash charges consisting primarily of \$24.7 million of depreciation and amortization, \$13.4 million of stock-based compensation, \$8.7 million of non-cash restructuring charges, \$6.8 million of provision for excess and obsolete inventories and \$56.8 million of impairment and loss on disposal of long-lived assets, offset by a gain of \$3.5 million related to the release of certain secured borrowings. Net cash provided by the net change in operating assets and liabilities for the nine months ended September 25, 2010 was \$3.3 million.

***Cash flows from investing activities:*** Net cash provided by investing activities for the nine months ended September 24, 2011 was primarily related to \$233.0 million proceeds from maturities and sales of marketable securities partially offset by purchases of marketable securities totaling \$182.2 million and \$4.9 million cash used in the acquisition of property and equipment for new product technology. We carefully monitor our investments to minimize risks and have not experienced other than temporary investment losses. Except for experiencing declining yields, our investment portfolio has not been negatively impacted by the economic turmoil in the credit markets in the recent past.

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Net cash provided by investing activities for the nine months ended September 25, 2010 was primarily related to \$331.2 million proceeds from maturities and sales of marketable securities offset by purchases of marketable securities totaling \$257.1 million and \$22.5 million cash used in the acquisition of property and equipment for new product technology.

**Cash flows provided by financing activities:** Net cash used in financing activities for the nine months ended September 24, 2011 included \$8.5 million used for the repurchase and retirement of our common stock partially offset by \$3.5 million in proceeds received from purchases under our 2002 Employee Stock Purchase Plan, or ESPP, and net proceeds from the exercise of stock options offset by stock withheld in lieu of payment of employee taxes related to the release of restricted stock units.

Net cash provided by financing activities for the nine months ended September 25, 2010 included \$3.8 million proceeds received from the January 2010 and July 2010 purchases under our ESPP and net proceeds received from the exercises of stock options offset by stock withheld in lieu of payment of employee taxes related to the release of restricted stock units.

Our cash, cash equivalents and marketable securities declined in the nine months ended September 24, 2011. We continue to focus on improving our operating efficiency to achieve break even operating cash flow. Our actions have included operational expense reduction initiatives, re-timing or eliminating certain capital spending and research and development projects and re-negotiating longer payment terms with our vendors. We believe that we will be able to satisfy our cash requirements for the next twelve months with the liquidity provided by our existing cash, cash equivalents and marketable securities. To the extent necessary, we may also consider establishing manufacturing and technology partnerships, or to seek short and long-term debt obligations, or to obtain new financing facilities which may not be available on terms favorable to us or at all. Our future capital requirements may vary materially from those now planned. However, if we are unsuccessful in improving our operating efficiency, executing our cost reduction plan, reducing our cash outlays or increasing our available cash through financing, our cash, cash equivalents and marketable securities will further decline in the remaining quarters of fiscal 2011.

**Off-Balance Sheet Arrangements**

Historically, we have not participated in transactions that have generated relationships 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. As of September 24, 2011, we were not involved in any such off-balance sheet arrangements.

**Recent Accounting Pronouncements**

For a discussion on the impact of recently issued accounting pronouncements, please refer to Note 2 – Recent Accounting Pronouncements and Other Reporting Considerations of the Notes to Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q.

**Critical Accounting Policies and Estimates**

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Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 25, 2010. Other than our revenue recognition accounting policy, which is discussed in Note 2 of the Notes to Condensed Consolidated Financial Statements, our critical accounting policies have not materially changed during the three and nine months ended September 24, 2011.

Furthermore, the preparation of our consolidated financial statements and related disclosures in conformity with GAAP requires our management to make judgments and estimates that affect the amounts reported in our consolidated financial statements and accompanying notes. Our management believes that we consistently apply these judgments and estimates and the consolidated financial statements and accompanying notes fairly represent all periods presented. However, any differences between these judgments and estimates and actual results could have a material impact on our consolidated statements of income and financial position. Critical accounting estimates, as defined by the SEC, are those that are most important to the portrayal of our consolidated financial condition and results of operations and require our management's most difficult and subjective judgments and estimates of matters that are inherently uncertain. Our critical accounting estimates include those regarding (1) revenue recognition, (2) marketable securities, (3) restructuring charges, (4) warranty accruals, (5) valuation of inventories, (6) allowance for doubtful accounts, (7) impairment of long-lived assets, (8) income taxes and (9) stock-based compensation. For a discussion of our critical accounting estimates, see Item 7: Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Estimates in our Annual Report on Form 10-K for the year ended December 25, 2010.



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**Item 3. *Quantitative and Qualitative Disclosures about Market Risk***

For financial market risks related to changes in interest rates and foreign currency exchange rates, reference is made to Item 7A: Quantitative and Qualitative Disclosures about Market Risk contained in Part II of our Annual Report on Form 10-K for the fiscal year ended December 25, 2010. Our exposure to market risk has not changed materially since December 25, 2010.

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

**Evaluation of Disclosure Controls and Procedures**

Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

**Changes in Internal Control over Financial Reporting**

There have been no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Limitations on the Effectiveness of Controls**

Control systems, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control systems objectives are being met. Further, the design of any control systems must reflect the fact that there are resource constraints, and the benefits of all controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Control systems can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based, in part, on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

**CEO and CFO Certifications**

We have attached as exhibits to this Quarterly Report on Form 10-Q the certifications of our Chief Executive Officer and Chief Financial Officer, which are required in accordance with the Exchange Act. We recommend that this Item 4 be read in conjunction with the certifications for a more complete understanding of the subject matter presented.

**PART II. OTHER INFORMATION**

**Item 1. Legal Proceedings**

The information relating to *Legal Matters* set forth under Note 16 - Commitments and Contingencies of the Notes to Condensed Consolidated Financial Statements of this Quarterly Report on Form 10-Q is incorporated herein by reference.

**Item 1A. Risk Factors**

In addition to the other information in this Quarterly Report on Form 10-Q, you should carefully consider the risk factors discussed in our Annual Report on Form 10-K for the year ended December 25, 2010, and in our Quarterly Reports on Form 10-Q for the quarters ended March 26, 2011 and June 25, 2011. If any of the identified risks actually occur, our business, financial condition and results of operations could suffer. The trading price of our common stock could decline and you may lose all or part of your investment in our common stock. The risks and uncertainties described in our Annual Report on Form 10-K and in our Quarterly Report on Form 10-Q for the quarters ended March 26, 2011 and June 25, 2011 are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

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**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

**Repurchase of Common Stock**

On October 20, 2010, the Company's Board of Directors authorized a program to repurchase up to \$50.0 million of outstanding common stock. Under the authorized stock repurchase program, the Company may repurchase shares from time to time on the open market; the pace of repurchase activity will depend on levels of cash generation, current stock price, and other factors. The stock repurchase program was announced on October 26, 2010 had a scheduled expiration date of October 19, 2011. The program may be modified or discontinued at any time. During fiscal year 2010 we repurchased and retired 70,000 shares of common stock for \$0.6 million under this repurchase authorization. During the first fiscal quarter of 2011 we repurchased and retired an additional 262,712 shares for \$2.3 million, and during the second fiscal quarter of 2011 we repurchased and retired 117,437 shares for \$1.0 million. During the third fiscal quarter of 2011 we repurchased and retired an additional 695,134 shares for \$5.5 million.

On October 12, 2011, our Board of Directors authorized the extension of this repurchase program through October 19, 2012. Under the existing program, we may repurchase up to \$40.5 million of outstanding common stock during the program period. The terms and conditions of the extended repurchase program remain the same as those in the original program approved in fiscal 2010.

The following table summarizes our repurchases of outstanding common stock for the nine months ended September 24, 2011:

Period (Fiscal months)	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Amount that May Yet Be Purchased Under the Plans or Programs
December 26, 2010 - January 22, 2011	130,000	\$ 8.95	130,000	\$ 48,209,833
January 23, 2011 - February 19, 2011				\$ 48,209,833
February 20, 2011 - March 26, 2011	132,712	\$ 8.76	132,712	\$ 47,046,921
March 27, 2011 - April 23, 2011				\$ 47,046,921
April 24, 2011 - May 21, 2011				\$ 47,046,921
May 21, 2011 - June 25, 2011	117,437	\$ 8.85	117,437	\$ 46,007,951
June 26, 2011 - July 23, 2011				\$ 46,007,951
July 24, 2011 - August 20, 2011	500,000	\$ 8.21	500,000	\$ 41,903,981
August 21, 2011 - September 24, 2011	195,134	\$ 7.30	195,134	\$ 40,478,747
	1,075,283	\$ 8.27	1,075,283	

Repurchased shares are retired upon the settlement of the related trade transactions. Our policy related to repurchases of our common stock is to charge the excess of cost over par value to additional paid-in capital. All repurchases were made in compliance with Rule 10b-18 under the Securities Exchange Act of 1934, as amended.

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#### **Item 6. Exhibits**

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
31.01	Certification of Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01	Certification of Chief Executive Officer and 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				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				X

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\* This exhibit shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.

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**SIGNATURE**

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.

FormFactor, Inc.

Date: October 27, 2011

By:

/s/ Michael M. Ludwig

Michael M. Ludwig  
Chief Financial Officer  
*(Duly Authorized Officer, Principal Financial Officer,  
and Principal Accounting Officer)*

Table of Contents**EXHIBIT INDEX**

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
31.01	Certification of Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01	Certification of Chief Executive Officer and 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				X
101.SCH	XBRL Taxonomy Extension Schema Document				X
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document				X
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document				X
101.LAB	XBRL Taxonomy Extension Label Linkbase Document				X
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document				X

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\* This exhibit shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934 or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference in any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934, whether made before or after the date hereof and irrespective of any general incorporation language in any filings.