

FORMFACTOR INC
Form 10-Q
August 03, 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 June 25, 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)

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 July 27, 2011, 50,849,589 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 JUNE 25, 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)**

| | Three Months Ended | | Six Months Ended | |
|---|---------------------------|--------------------------|--------------------------|--------------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Revenues | \$ 46,558 | \$ 57,640 | \$ 86,987 | \$ 97,306 |
| Cost of revenues | 36,668 | 53,710 | 73,027 | 95,704 |
| Gross profit | 9,890 | 3,930 | 13,960 | 1,602 |
| Operating expenses: | | | | |
| Research and development | 10,878 | 15,997 | 22,438 | 31,088 |
| Selling, general and administrative | 11,154 | 18,725 | 23,541 | 36,592 |
| Restructuring charges, net | (1,099) | 2,513 | (60) | 6,063 |
| Impairment of long-lived assets | | 999 | 351 | 999 |
| Total operating expenses | 20,933 | 38,234 | 46,270 | 74,742 |
| Operating loss | (11,043) | (34,304) | (32,310) | (73,140) |
| Interest income, net | 369 | 722 | 793 | 1,497 |
| Other income (expense), net | 584 | (82) | 210 | 35 |
| Loss before income taxes | (10,090) | (33,664) | (31,307) | (71,608) |
| Provision for (benefit from) income taxes | (2,412) | 200 | (2,205) | 440 |
| Net loss | \$ (7,678) | \$ (33,864) | \$ (29,102) | \$ (72,048) |
| Net loss per share: | | | | |
| Basic and Diluted | \$ (0.15) | \$ (0.68) | \$ (0.57) | \$ (1.44) |
| Weighted-average number of shares used in per share calculations: | | | | |
| Basic and Diluted | 50,773 | 50,084 | 50,705 | 49,989 |

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)**

| | June 25, 2011 | December 25, 2010 |
|---|--------------------------|------------------------------|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 130,085 | \$ 121,207 |
| Marketable securities | 194,142 | 226,028 |
| Restricted cash | 383 | 383 |
| Accounts receivable, net | 28,017 | 28,598 |
| Inventories | 21,799 | 25,003 |
| Deferred tax assets | 297 | 329 |
| Prepaid expenses and other current assets | 9,022 | 14,743 |
| Total current assets | 383,745 | 416,291 |
| Restricted cash | 297 | 297 |
| Property, plant and equipment, net | 35,078 | 37,311 |
| Deferred tax assets | 7,364 | 5,445 |
| Other assets | 5,110 | 6,710 |
| Total assets | \$ 431,594 | \$ 466,054 |
| LIABILITIES AND STOCKHOLDERS EQUITY | | |
| Current liabilities: | | |
| Accounts payable | \$ 16,023 | \$ 14,948 |
| Accrued liabilities | 15,176 | 24,045 |
| Income taxes payable | 382 | 1,894 |
| Deferred revenue | 4,409 | 4,637 |
| Total current liabilities | 35,990 | 45,524 |
| Long-term income taxes payable | 4,209 | 4,248 |
| Deferred rent and other liabilities | 4,101 | 5,081 |
| Total liabilities | 44,300 | 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 June 25, 2011 and December 25, 2010, respectively | | |
| Common stock, \$0.001 par value: 250,000,000 shares authorized; 50,849,589 and 50,587,917 shares issued and outstanding at June 25, 2011 and December 25, 2010, respectively | | |
| | 52 | 52 |
| Additional paid-in capital | 655,674 | 651,263 |
| Accumulated other comprehensive income | 2,811 | 2,027 |
| Accumulated deficit | (271,243) | (242,141) |
| Total stockholders' equity | 387,294 | 411,201 |
| Total liabilities and stockholders' equity | \$ 431,594 | \$ 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)

| | Six months ended | |
|---|------------------|------------------|
| | June 25, 2011 | June 26, 2010 |
| Cash flows from operating activities: | | |
| Net loss | \$ (29,102) | \$ (72,048) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 5,818 | 16,884 |
| Amortization of investments | 243 | 222 |
| Stock-based compensation expense | 6,321 | 9,152 |
| Deferred income tax benefit | (2,627) | (89) |
| Recovery of doubtful accounts receivable | (266) | (328) |
| Provision for excess and obsolete inventories | 3,524 | 512 |
| Loss (gain) on disposal of long-lived assets | (32) | 503 |
| Impairment of long-lived assets | 351 | 999 |
| Non-cash restructuring | (1,582) | 1,034 |
| Foreign currency transaction (gains) losses | (404) | 426 |
| Changes in assets and liabilities: | | |
| Accounts receivable | 1,065 | (13,976) |
| Inventories | (430) | (13,247) |
| Prepaid expenses and other current assets | 4,668 | 869 |
| Refundable income taxes | (12) | 26,349 |
| Other assets | 1,055 | (248) |
| Accounts payable | 1,456 | 1,192 |
| Accrued liabilities | (8,467) | 9,043 |
| Income tax payable | (824) | (212) |
| Deferred rent | (65) | (652) |
| Deferred revenues | (229) | (2,205) |
| Net cash used in operating activities | (19,539) | (35,820) |
| Cash flows from investing activities: | | |
| Acquisition of property, plant and equipment | (2,733) | (16,484) |
| Proceeds from sales of property, plant and equipment | 33 | |
| Purchases of marketable securities | (112,182) | (145,590) |
| Proceeds from maturities of marketable securities | 144,165 | 155,225 |
| Proceeds from sales of marketable securities | | 9,000 |
| Net cash provided by investing activities | 29,283 | 2,151 |
| Cash flows from financing activities: | | |
| Proceeds from issuances of common stock and awards, net of issuance costs | 1,576 | 1,536 |
| Purchase and retirement of common stock | (3,007) | |
| Net cash provided by (used in) financing activities | (1,431) | 1,536 |
| Effect of exchange rate changes on cash and cash equivalents | 565 | (834) |
| Net increase (decrease) in cash and cash equivalents | 8,878 | (32,967) |
| Cash and cash equivalents, beginning of period | 121,207 | 122,043 |
| Cash and cash equivalents, end of period | \$ 130,085 | \$ 89,076 |

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Supplemental cash flow disclosures:

| | | | | |
|---|----|-------|----|----------|
| Changes in accounts payable and accrued liabilities related to property and equipment purchases | \$ | (406) | \$ | 1,026 |
| Income taxes paid (refunded) | \$ | 1,263 | \$ | (25,625) |

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 six months ended June 25, 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, Statement of Cash Flows and Statement of Operations to conform to the current year 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 six months ended June 25, 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 any impact on our consolidated financial position, results of operations, or cash flows for the three and six months ended June 25, 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.

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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 invest our excess cash primarily in U.S. banks, 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. Four customers represented 17%, 15%, 12% and 10% of total revenues during the three months ended June 25, 2011, and four customers also represented 28%, 12%, 12% and 11% of total revenues during the three months ended June 26, 2010. Five customers represented 16%, 11%, 11%, 10% and 10% of total revenues during the six months ended June 25, 2011, and three customers represented 22%, 14% and 12% of total revenues during the six months ended June 26, 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 June 25, 2011, two customers accounted for approximately 23% and 15% 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 in either of these fiscal periods.

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 \$3.6 million in restructuring charges in the three months ended March 27, 2010 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. We recorded \$3.6 million and \$27,000 in charges for the Q1 2010 Restructuring Plan in the first and second quarter of fiscal 2010, which were all related to severance and related benefits.

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

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arrangements for certain employees impacted by the Q1 2010 Restructuring Plan. As a result of this rescission plan, as of June 26, 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 in charges for the Q2 2010 Restructuring Plan in the second quarter of fiscal 2010 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 an impairment charge of approximately \$0.9 million, representing the net book value of these assets.

The activities comprising the above reductions in force were substantially completed by the end of fiscal 2010.

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 are expected to be 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. In addition, we have been granted a rent reduction for the remaining occupied facilities in this building. We previously had 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, we have recorded a benefit of \$1.5 million to Restructuring charges, net in our Condensed Consolidated Statement of Operations for the three and six months ending June 25, 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 third quarter of fiscal 2011. As such, the restructuring accrual is recorded as a current liability within Accrued liabilities in the Condensed Consolidated Balance Sheets.

The activities in the restructuring accrual for the six months ended June 25, 2011 were as follows (in thousands):

| | Employee Severance and Benefits | Contract Termination and Other | Total |
|--|--|---|--------------|
| 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 |

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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 are 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 in generally accepted accounting principles, 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. We apply the following fair value hierarchy, which prioritizes the inputs used in measuring fair value as follows: The accounting standard for fair value 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:

- 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.

- 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 June 25, 2011 (in thousands):

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| | Level 1 | Level 2 | Total |
|------------------------------|------------------|-------------------|-------------------|
| Assets: | | | |
| Cash equivalents | | | |
| Money market funds | \$ 93,088 | \$ | \$ 93,088 |
| U. S. Treasury | | 5,000 | 5,000 |
| Agency securities | | 9,999 | 9,999 |
| Commercial paper | | 5,000 | 5,000 |
| Marketable securities | | | |
| U. S. Treasury | | 86,311 | 86,311 |
| Agency securities | | 97,336 | 97,336 |
| Commercial paper | | 10,495 | 10,495 |
| Total | \$ 93,088 | \$ 214,141 | \$ 307,229 |

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

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

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 June 25, 2011 and June 26, 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 six months ended June 25, 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 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 June 25, 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

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market transactions and inherent lack of liquidity.

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 six months ended June 25, 2011 and June 26, 2010.

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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.

Note 6 Marketable Securities

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 June 25, 2011 consisted of the following (in thousands):

| | Amortized Cost | | Gross Unrealized Gains | | Gross Unrealized Losses | | Fair Value |
|-------------------|-------------------|----|------------------------------|----|-------------------------------|----|---------------|
| U. S. Treasury | \$ 85,957 | \$ | 354 | \$ | | \$ | 86,311 |
| Agency Securities | 97,188 | | 151 | | (3) | | 97,336 |
| Commercial Paper | 10,496 | | | | (1) | | 10,495 |
| | \$ 193,641 | \$ | 505 | \$ | (4) | \$ | 194,142 |

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 June 25, 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 June 25, 2011 were as follows (in thousands):

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| | Amortized Cost | | Fair Value | |
|-----------------------------------|-------------------|---------|---------------|---------|
| Due in one year or less | \$ | 93,420 | \$ | 93,605 |
| Due after one year to three years | | 100,221 | | 100,537 |
| | \$ | 193,641 | \$ | 194,142 |

Realized gains and losses on sales and maturities of marketable securities were immaterial for the three and six months ended June 25, 2011 and June 26, 2010, respectively.

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 quarter 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 June 25, 2011 and June 26, 2010, respectively (in thousands):

| | Allowance for Doubtful Accounts Receivable Activity for fiscal quarters ended: | | | |
|--------------------------------------|--|-------|------------------|-------|
| | June 25, 2011 | | June 26, 2010 | |
| 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 |

Table of Contents**Note 8 Inventories**

Inventories consisted of the following (in thousands):

| | June 25, 2011 | | December 25, 2010 | |
|------------------|--------------------------|--------|------------------------------|--------|
| Raw materials | \$ | 6,139 | \$ | 2,736 |
| Work-in-progress | | 9,865 | | 16,807 |
| Finished goods | | 5,795 | | 5,460 |
| | \$ | 21,799 | \$ | 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

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 June 25, 2011 and June 26, 2010, respectively (in thousands):

| | Warranty Accrual Activity for fiscal quarters ended: | | | |
|---|---|-------|--------------------------|-------|
| | June 25, 2011 | | June 26, 2010 | |
| 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 |

Note 10 Long-lived Assets

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

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| | June 25, 2011 | | December 25, 2010 |
|--|------------------|-----------|----------------------|
| Building | \$ | 790 | \$ |
| Machinery and equipment | | 123,564 | 115,847 |
| Computer equipment and software | | 35,511 | 35,493 |
| Furniture and fixtures | | 6,063 | 6,180 |
| Leasehold improvements | | 70,212 | 69,934 |
| | | 236,140 | 227,454 |
| Less: Accumulated depreciation, amortization and enterprise-wide impairment | | (213,927) | (207,992) |
| | | 22,213 | 19,462 |
| Construction-in-progress | | 12,865 | 17,849 |
| | \$ | 35,078 | \$ 37,311 |

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.

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During the three and six months ended June 25, 2011 we wrote-off fully depreciated assets with an acquired cost of \$0.2 million and \$0.4 million, respectively. In addition, 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. This impairment charge is included in *Impairment of long-lived assets* in the Condensed Consolidated Statements of Operations for the six months ended June 25, 2011.

At June 25, 2011, the carrying amount of our intangible asset, which consists of purchased intellectual property, was \$3.8 million, with \$5.9 million as the gross amount and \$2.1 million as the accumulated amortization. We recorded \$0.3 million and \$0.6 million amortization expense for our intangible asset during the three and six months ended June 25, 2011, respectively, all of which was charged to cost of revenues. The intangible asset had a remaining amortization period of 3.3 years at June 25, 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):

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Net loss | \$ (7,678) | \$ (33,864) | \$ (29,102) | \$ (72,048) |
| Unrealized gain on investments, net | 237 | 336 | 210 | 350 |
| Cumulative translation adjustments | 284 | 89 | 574 | (29) |
| Comprehensive loss | \$ (7,157) | \$ (33,439) | \$ (28,318) | \$ (71,727) |

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

| | June 25, 2011 | December 25, 2010 |
|--|------------------|----------------------|
| Unrealized gain (loss) on marketable securities, net of tax of \$428 at June 25, 2011 and \$299 at December 25, 2010, respectively | \$ 74 | \$ (136) |
| Cumulative translation adjustments | 2,737 | 2,163 |
| Accumulated other comprehensive income | \$ 2,811 | \$ 2,027 |

Note 12 Stockholders' Equity

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 expires on 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 an additional 117,437 shares for \$1.0 million.

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.

Table of Contents**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 six months ended June 25, 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 | 4.66 | \$ 1,390,870 |
| Vested and expected to vest at June 25, 2011 | 4,742,994 | \$ 14.00 | 4.52 | \$ 1,307,436 |
| Exercisable at June 25, 2011 | 1,779,537 | \$ 21.01 | 2.20 | \$ 741,670 |

The intrinsic value of option exercises during the three and six months ended June 25, 2011 was \$17,000 and \$60,000, respectively. Cash received from stock option exercises during the three and six months ended June 25, 2011 was \$39,000 and \$0.1 million, respectively. We did not realize any gross tax benefits in connection with these exercises.

Restricted Stock Units

Restricted stock unit activity under the 2002 Plan during the six months ended June 25, 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 |

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.

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The table below shows the stock-based compensation charges included in the Condensed Consolidated Statements of Operations (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Stock-based compensation expense included in: | | | | |
| Cost of revenues | \$ 758 | \$ 994 | \$ 1,603 | \$ 1,965 |
| Research and development | 951 | 1,963 | 2,212 | 3,356 |
| Selling, general and administrative | 644 | 937 | 2,507 | 3,831 |
| Restructuring | | 176 | | 176 |
| Total stock-based compensation | 2,353 | 4,070 | 6,322 | 9,328 |
| Tax effect on stock-based compensation | | | | |
| Total stock-based compensation, net of tax | \$ 2,353 | \$ 4,070 | \$ 6,322 | \$ 9,328 |

Stock Options

During the three and six months ended June 25, 2011, we granted 257,500 and 459,750 stock options, respectively, under the 2002 Plan with a weighted average grant-date fair value of \$4.34 and \$4.06, respectively. During the three months ended June 26, 2010, we granted 420,570 stock options under the 2002 Plan with a weighted average grant-date fair value of \$6.37 and no stock options under the 2002 Plan were granted during the quarter ended March 27, 2010. The following weighted-average assumptions were used in the estimated grant-date fair value calculations for stock options:

| | Three Months Ended | | Six Months Ended | |
|--------------------------|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Stock Options: | | | | |
| Dividend yield | % | % | % | % |
| Expected volatility | 50.54% | 49.74% | 50.30% | 49.74% |
| Risk-free interest rate | 1.65% | 1.91% | 1.67% | 1.91% |
| Expected term (in years) | 4.29 | 4.47 | 4.26 | 4.47 |

Employee Stock Purchase Plan

There were no shares issued under the Employee Stock Purchase Plan (ESPP) during the three months ended June 25, 2011 and June 26, 2010, respectively. During the six months ended June 25, 2011 and June 26, 2010, we issued 228,737 shares and 157,961 shares, respectively, 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 | | Six months ended | |
|--------------|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| ESPP: | | | | |

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| | | | | |
|--------------------------|--------|--------|--------|--------|
| Dividend yield | % | % | % | % |
| Expected volatility | 52.63% | 38.90% | 51.51% | 42.54% |
| Risk-free interest rate | 0.18% | 0.17% | 0.20% | 0.22% |
| Expected term (in years) | 0.5 | 0.5 | 0.5 | 0.5 |

Unrecognized Compensation Costs

At June 25, 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 | \$ | 12,468 | 2.38 |
| Restricted stock units | | 14,892 | 2.51 |
| Employee Stock Purchase Plan | | 98 | 0.09 |
| Total unrecognized stock-based compensation expense | \$ | 27,458 | |

Table of Contents**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 three and six months ended June 25, 2011 and June 26, 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 | | Six Months Ended | |
|--|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Numerator: | | | | |
| Net loss used in computing basic and diluted net loss per share | \$ (7,678) | \$ (33,864) | \$ (29,102) | \$ (72,048) |
| Denominator: | | | | |
| Weighted-average shares used in computing basic net loss per share | 50,773 | 50,084 | 50,705 | 49,989 |
| Add potentially dilutive securities | | | | |
| Weighted average shares used in computing diluted net loss per share | 50,773 | 50,084 | 50,705 | 49,989 |

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 | | Six Months Ended | |
|---------------------------------------|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Options to purchase common stock | 4,834 | 5,076 | 4,846 | 5,134 |
| Restricted stock units | 1,210 | 596 | 1,080 | 88 |
| Employee Stock Purchase Plan | 27 | 174 | 14 | 174 |
| Total potentially dilutive securities | 6,071 | 5,846 | 5,940 | 5,396 |

Note 15 Income Taxes

We recorded an income tax benefit of \$2.4 million and \$2.2 million for the three and six months ended June 25, 2011, respectively, and an income tax provision of \$0.2 million and \$0.4 million for the three and six months ended June 26, 2010, respectively. The income tax benefit recorded for the three months and six months ended June 25, 2011 primarily relates to a \$2.5 million release of the deferred tax valuation allowance for a non-US 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 six months ended June 26, 2010 reflects the tax provision on our non-U.S. operations in foreign jurisdictions. We

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continue to maintain a valuation allowance for our U.S. Federal and state deferred tax assets.

During the quarter ended June 25, 2011, we determined that it is more likely than not that the deferred tax assets of a non-US 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 \$0.7 million to \$18.2 million during the six months ended June 25, 2011 primarily as a result of additional R&D credit reserves and foreign transfer pricing reserves. If recognized, \$14.3 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.

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We classify interest and penalties related to uncertain tax positions as part of the income tax provision. For the three months and six months ended June 25, 2011, we recognized interest benefits and penalties of approximately \$9,000 and \$2,000, respectively. For the three months and six months ended June 26, 2010, we recognized interest charges and penalties of approximately \$46,000 and \$0.1 million, respectively. As of June 25, 2011 and June 26, 2010, we have accrued total interest and penalties of \$0.4 million and \$0.9 million related to the 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 six months of 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 June 25, 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 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 potential future payments we could be obligated to make, or for limitations on the types of claims and damages we could be obligated to indemnify, or for 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. 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 June 25, 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 June 25, 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

In July 2011 we received an inquiry from a foreign jurisdiction tax authority regarding certain indirect tax matters. We plan to cooperate 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.

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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 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 stay in the district court action against Phicom, now operating under the name TSC MEMSYS Co. Ltd., was lifted and the parties engaged in a non-binding mediation in an attempt to amicably resolve the litigation. We anticipate that the matter will be resolved amicably 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 proprietary 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.

No provision has been made for patent-related litigation because we believe that it is not probable that a liability had been incurred as of June 25, 2011. We will incur material attorneys' fees in prosecuting and defending the various identified actions.

Table of Contents**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.

As of June 25, 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 | 328,170 | \$ 4,066 |
| Korean Won | Buy | (40,360) | (1,398) |
| Taiwan Dollar | Buy | (893,408) | (828) |
| Total USD notional amount of outstanding foreign exchange contracts | | | \$ 1,840 |

The contracts were entered into on June 23, 2011 and matured on June 28, 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 June 25, 2011. Additionally, no gains or losses relating to the outstanding derivative contracts were recorded in the three and six months ended June 25, 2011.

The location and amount of gains and losses related to non-designated derivative instruments that matured in the three and six months ended June 25, 2011 and June 26, 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 | | Six Months Ended | |
| | | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Foreign exchange forward contracts | Other income (expense), net | \$ (73) | \$ (258) | \$ (289) | \$ (439) |

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**Cautionary Statement Regarding Forward-Looking Statements**

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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.

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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.

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 in 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 ATRETM wafer test technology.

During the three and six months ended June 25, 2011, we saw revenue decline over the same periods in fiscal 2010 across our DRAM and Flash product markets. Our revenues decreased by 19.2%, or \$11.1 million, in the three months ended June 25, 2011 as compared to the same period in fiscal 2010 and by 10.6%, or \$10.3 million, in the six months ended June 25, 2011 as compared to the same period in fiscal 2010. This decline 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.

We incurred a net loss of \$7.7 million in the second quarter of fiscal 2011 as compared to a net loss of \$33.9 million for the second quarter of fiscal 2010. The reduction in net loss quarter over quarter is primarily attributable 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. Net loss also decreased quarter over quarter due to a reduction in depreciation resulting from the enterprise-wide impairment recorded in fiscal 2010. The net loss for the second quarter of fiscal 2011 includes a benefit of \$1.5 million for the reversal of certain previously recorded restructuring charges related to our Singapore facilities, as well as a benefit of \$2.5 million related to the release of the valuation allowance on deferred tax assets in a non-U.S. jurisdiction. The net loss for the second quarter of fiscal 2010 includes \$2.5 million of pre-tax restructuring charges and \$0.6 million of severance costs related to change in executive management, as well as the impairment of certain fixed assets of \$1.0 million.

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We incurred a net loss of \$29.1 million in the first half of fiscal 2011 as compared to \$72.0 million in the first half of fiscal 2010. The reduction in net loss period over period is primarily attributable 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. Net loss also decreased period over period due to a reduction in depreciation resulting from the enterprise-wide impairment recorded in fiscal 2010.

Our cash, cash equivalents and marketable securities totaled approximately \$324.2 million as of June 25, 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 their procurement as well as payment decisions which could adversely delay and affect 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 the third 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, cyclicity 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.

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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 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.

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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Results of Operations

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

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Revenues | 100.0% | 100.0% | 100.0% | 100.0% |
| Cost of revenues | 78.8 | 93.2 | 83.9 | 98.4 |
| Gross profit | 21.2 | 6.8 | 16.1 | 1.6 |
| Operating expenses: | | | | |
| Research and development | 23.4 | 27.8 | 25.8 | 31.9 |
| Selling, general and administrative | 24.0 | 32.5 | 27.1 | 37.6 |
| Restructuring charges | (2.4) | 4.4 | (0.1) | 6.2 |
| Impairment of long-lived assets | | 1.7 | 0.4 | 1.0 |
| Total operating expenses | 45.0 | 66.4 | 53.2 | 76.7 |
| Operating loss | (23.8) | (59.6) | (37.1) | (75.1) |
| Interest income, net | 0.8 | 1.3 | 0.9 | 1.5 |
| Other income (expense) | 1.3 | (0.1) | 0.2 | 0.0 |
| Loss before income taxes | (21.7) | (58.4) | (36.0) | (73.6) |
| Provision for (benefit from) income taxes | (5.2) | 0.3 | (2.5) | 0.5 |
| Net loss | (16.5)% | (58.7)% | (33.5)% | (74.1)% |

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Three and six months ended June 25, 2011 and June 26, 2010:

Revenues

| | June 25, 2011 | Three Months Ended June 26, 2010 | % Change (In thousands, except percentages) | June 25, 2011 | Six Months Ended June 26, 2010 | % Change |
|---------------------|------------------|--|--|------------------|--------------------------------------|----------|
| Revenues by Market: | | | | | | |
| DRAM | \$ 33,926 | \$ 42,390 | -20.0% | \$ 60,799 | \$ 74,158 | -18.0% |
| Flash | 5,214 | 8,434 | -38.2 | 11,461 | 11,894 | -3.6 |
| SOC | 7,418 | 6,816 | 8.8 | 14,727 | 11,254 | 30.9 |
| Total revenues | \$ 46,558 | \$ 57,640 | -19.2% | \$ 86,987 | \$ 97,306 | -10.6% |

Revenues for the three and six months ended June 25, 2011 decreased 19.2%, or \$11.1 million, and 10.6%, or \$10.3 million, compared to the revenues of the comparable periods of the prior year. The decreases are primarily due to reduced volume of shipments of advanced wafer probe cards for the DRAM and Flash memory market segments.

Our revenues for the three and six months ended June 25, 2011 were primarily generated by sales of wafer probe cards to manufacturers of DRAM devices. DRAM sales were lower in the three and six months ended June 25, 2011 as compared to the same periods in the prior year primarily due to reduced volumes at certain customers, generally resulting from extended qualification periods for the SmartMatrix product family at those customers, as well as lost business opportunities due to quoted lead times. These declines were partially offset by the overall upturn in the semiconductor industry period over period.

Revenues from sales to Flash memory device manufacturers decreased in the three months ended June 25, 2011 compared to the same period 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. Flash revenue was flat for the six months ended June 25, 2011 compared to the same period in the prior year.

Revenues from sales to SOC device manufacturers increased in the three and six months ended June 25, 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 to more complex devices and higher parallelism offered by SOC devices, which positively impacted revenues from sales of our wafer probe cards in this market.

Revenues by Geographic Region

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

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| | Three Months Ended | | % of | | June 25, | | Six Months Ended | | % of | |
|------------------------------------|--------------------|-----------------|------------------|-----------------|------------------|-----------------|------------------|-----------------|------|--|
| | June 25, 2011 | % of Revenue | June 26, 2010 | % of Revenue | June 25, 2011 | % of Revenue | June 26, 2010 | % of Revenue | | |
| (In thousands, except percentages) | | | | | | | | | | |
| Taiwan | \$ 20,641 | 44.3% | \$ 22,464 | 39.0% | \$ 34,368 | 39.5% | \$ 37,026 | 38.1% | | |
| Japan | 8,790 | 18.9 | 12,333 | 21.4 | 13,216 | 15.2 | 16,841 | 17.3 | | |
| North America | 4,835 | 10.4 | 11,447 | 19.9 | 13,356 | 15.4 | 20,011 | 20.5 | | |
| South Korea | 8,455 | 18.2 | 6,447 | 11.2 | 16,618 | 19.1 | 11,440 | 11.8 | | |
| Asia Pacific (1) | 2,679 | 5.7 | 2,381 | 4.1 | 5,856 | 6.7 | 7,333 | 7.5 | | |
| Europe | 1,158 | 2.5 | 2,568 | 4.4 | 3,573 | 4.1 | 4,655 | 4.8 | | |
| Total revenues | \$ 46,558 | 100.0% | \$ 57,640 | 100.0% | \$ 86,987 | 100.0% | \$ 97,306 | 100.0% | | |

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

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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 six months ended June 25, 2011 compared to the same periods in the prior year were 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. The decrease in Europe was primarily driven by reductions in SOC, while the decrease in revenues in Asia-Pacific in the six month period ended June 25, 2011 was primarily due to a decrease in both DRAM and SOC shipments into that region. 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.

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

| | Three Months Ended | | Six Months Ended | |
|-----------------------------|--------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| Elpida Memory (1) | 17.0% | 28.1% | 16.3% | 21.6% |
| Inotera Memories, Inc. | 15.2 | 11.8 | * | * |
| Samsung (2) | 11.7 | 12.0 | 10.4 | 12.4 |
| Powerchip Semiconductor (3) | 10.2 | * | 10.3 | * |
| Micron Technology (4) | * | * | 10.9 | * |
| Hynix Semiconductor (5) | * | 10.5 | 11.4 | 13.8 |

-
- (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 Powerchip Semiconductor, Inc. and its wholly-owned subsidiary PowerFlash Technology Corp.
- (4) Includes Micron Technology, Inc. and its consolidated subsidiaries, including Micron Semiconductor Asia Pte. Ltd., Numonyx Pte. Ltd., Numonyx Israel Ltd. and Micron Japan, Ltd.
- (5) Includes Hynix Semiconductor and its consolidated subsidiary Hynix-Numonyx Semiconductor.
- * Less than 10% of revenues.

The percentages above reflect customer constellations as of June 25, 2011. Prior period concentrations have been updated to reflect the current customer compositions.

Gross Profit

| | Three Months Ended | | Six Months Ended | |
|--------------|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Gross profit | \$ 9,890 | \$ 3,930 | \$ 13,960 | \$ 1,602 |
| Gross margin | 21.2% | 6.8% | 16.1% | 1.6% |

Gross margin fluctuates with revenue levels, product mix, selling prices, factory loading, and material costs. For the three and six months ended June 25, 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 six months ended June 25, 2011 compared to the same fiscal 2010 periods was driven by \$2.6 million and \$1.5 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 initiatives that have been undertaken 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 six months ended June 25, 2011 was \$0.6 million and \$1.4 million, respectively. The increase in gross margin also included \$3.6 million and \$7.3 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 \$3.3 million and \$4.5 million, respectively, in general overhead resulting from our cost control initiatives. We also experienced certain favorable changes in product mix from lower margin to higher margin products.

Gross margin included stock-based compensation of \$0.8 million and \$1.6 million for the three and six months ended June 25, 2011, respectively, compared to \$1.0 million and \$2.0 million for the three and six months ended June 26, 2010, respectively, with the decrease being primarily due to the decrease in headcount and the full vesting of the shares that were granted in the first half of fiscal 2007, partially offset by expense related to current quarter grants.

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In the future, our gross margins may be adversely affected by lower levels of product revenues, even though we have taken significant steps to reduce our operating cost structure. Additionally, our gross margins may be adversely affected if, amongst other things, we are required to record additional inventory provision charges and inventory write-downs if estimated average selling prices of products held in finished goods inventories are below the manufacturing cost of those products.

Research and Development

| | Three Months Ended | | Six Months Ended | |
|--------------------------|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Research and development | \$ 10,878 | \$ 15,997 | \$ 22,438 | \$ 31,088 |
| % of revenues | 23.4% | 27.8% | 25.8% | 31.9% |

Research and development expenses for the three and six months ended June 25, 2011 decreased by approximately \$5.1 million and \$8.7 million, respectively, 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 six months ended June 25, 2011 compared to the three and six months ended June 26, 2010 due to our cost reduction efforts.

In the three and six months ended June 25, 2011, costs related to our research and development activities decreased by approximately \$4.2 million and \$7.5 million, respectively, from the comparable periods of fiscal 2010 resulting primarily from reduced payroll and related costs of \$2.5 million and \$3.7 million, respectively, driven by reduced headcount, and reduced materials and related costs of \$0.8 million and \$1.5 million, respectively. We also had a decrease in depreciation and facilities related costs of \$0.6 million and \$1.2 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 \$1.0 million and \$2.2 million for the three and six months ended June 25, 2011 compared to \$2.0 million and \$3.4 million for the three and six months ended June 26, 2010, with the decrease being primarily due to the decrease in headcount and the full vesting of the shares that were granted in the first half of fiscal 2007, partially offset by expense related to current quarter 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 | | Six Months Ended | |
|-------------------------------------|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Selling, general and administrative | \$ 11,154 | \$ 18,725 | \$ 23,541 | \$ 36,592 |

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| | | | | |
|---------------|-------|-------|-------|-------|
| % of revenues | 24.0% | 32.5% | 27.1% | 37.6% |
|---------------|-------|-------|-------|-------|

Selling, general and administrative expenses for the three and six months ended June 25, 2011 decreased \$7.6 million and \$13.1 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 six months ended June 25, 2011 as compared to the comparable periods of the prior year, primarily due to the reduction of expenses discussed above.

In the three and six months ended June 25, 2011, salary and payroll related costs for selling, general and administrative functions decreased by \$3.2 million and \$5.1 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 \$0.1 million and \$1.4 million, respectively, as well as a reduction in facilities related costs of \$1.0 million and \$2.0 million during the three and six months ended June 25, 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 \$1.6 million and \$1.7 million during the three and six months ended June 25, 2011 compared with the same periods of fiscal 2010. Stock-based compensation expenses included within selling, general and administrative expense were \$0.6 million and \$2.5 million for the three and six months ended June 25, 2011 compared to \$0.9 million and \$3.8 million for the comparable periods of the prior year. The decrease in stock-based compensation was primarily due to reduced headcount and the full vesting of the shares that were granted in the first half of fiscal 2007, partially offset by expense related to current quarter grants.

Table of Contents***Restructuring Charges, net***

| | Three Months Ended | | Six Months Ended | |
|----------------------------|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Restructuring charges, net | \$ (1,099) | \$ 2,513 | \$ (60) | \$ 6,063 |
| % of revenues | (2.4)% | 4.4% | (0.1)% | 6.2% |

For the three and six months ended June 25, 2011, restructuring charges decreased \$3.6 million and \$6.1 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 continue expect to continue to realize, quarterly savings, excluding stock-based compensation expenses, of approximately \$0.6 million in subsequent quarters.

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. We expect that the activities comprising this reduction in workforce will be completed by the end of the third quarter of fiscal 2011. As a result of the Q2 2011 Restructuring Plan, we expect 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. In addition, we have been granted a rent reduction for the remaining occupied facilities in this building. We previously had 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, we have recorded a benefit of \$1.5 million to Restructuring charges, net in our Condensed Consolidated Statement of Operations for the three and six months ended June 25, 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 third quarter of fiscal 2011.

2010 Restructuring Activities

We recorded \$3.6 million in restructuring charges in the three months ended March 27, 2010 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 in charges for the Q2 2010 Restructuring Plan in the second quarter of fiscal 2010 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 an impairment charge of approximately \$0.9 million, representing the net book value of these assets.

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The activities comprising the above reductions in force were substantially completed by the end of fiscal 2010.

Impairment of Long-lived Assets

| | Three Months Ended | | Six Months Ended | |
|---------------------------------|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Impairment of long-lived assets | \$ | \$ 999 | \$ 351 | \$ 999 |
| % of revenues | % | 1.7% | 0.4% | 1.0% |

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 projected related to certain software development for internal use that had been recorded in construction-in-progress. 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. There were no impairment charges recorded during the three months ended June 25, 2011.

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 operating results anticipated by our 2011 financial plan.

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

| | Three Months Ended | | Six Months Ended | |
|-----------------------------|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Interest income, net | \$ 369 | \$ 722 | \$ 793 | \$ 1,497 |
| % of revenue | 0.8% | 1.3% | 0.9% | 1.5% |
| Other income (expense), net | \$ 584 | \$ (82) | \$ 210 | \$ 35 |
| % of revenues | 1.3% | (0.1)% | 0.2% | 0.0% |

The decrease in interest income from cash, cash equivalents and marketable securities for the three and six months ended June 25, 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 \$324.9 million at June 25, 2011 compared to \$398.4 million at June 26, 2010. Weighted average yields for the three months ended June 25, 2011 and June 26, 2010 were 0.48% and 0.74%, respectively, and the weighted average yields for the six months ended June 25, 2011 and June 26, 2010 were 0.51% 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 and six months ended June 25, 2011 was mainly comprised of payments received from an intellectual property settlement and from foreign currency losses primarily related to Korean Won and Japanese Yen. Other income (expense), net for the three and six months ended June 26, 2010 was mainly comprised 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 | | Six Months Ended | |
|---|------------------------------------|------------------|------------------|------------------|
| | June 25, 2011 | June 26, 2010 | June 25, 2011 | June 26, 2010 |
| | (In thousands, except percentages) | | | |
| Provision for (benefit from) income taxes | \$ (2,412) | \$ 200 | \$ (2,205) | \$ 440 |
| Effective tax rate | 23.9% | 0.6% | 7.0% | 0.6% |

We recorded an income tax benefit of \$2.4 million and \$2.2 million for the three months and six months ended June 25, 2011, respectively, and an income tax provision of \$0.2 million and \$0.4 million for the three and six months ended June 26, 2010, respectively. The income tax benefit recorded for the three months and six months ended June 25, 2011, primarily relates to a \$2.5 million release of the deferred tax valuation allowance for a non-U.S. jurisdiction. The tax benefit was offset by income tax expense in certain foreign jurisdictions. The income tax provision recorded for the three and six months ended June 25, 2010 primarily related to on our non-U.S. operations.

During the quarter ended June 25, 2011, we determined that it is more likely than not that the deferred tax assets of a non-US 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 six months ended June 25, 2011 we recognized interest benefits of \$9,000 and \$2,000, respectively. For the three and six months ended June 25, 2010, we recognized interest charges of \$46,000 and \$0.1 million, respectively. We have not recognized any penalties in any of the periods presented. As of June 25, 2011 and June 26, 2010, we have accrued total interest charges and penalties of \$0.4 million and \$0.9 million, respectively, related to the unrecognized tax benefits.

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.

Liquidity and Capital Resources

| | June 25, 2011 | December 25, 2010 (In thousands) |
|--|------------------|--|
| Working capital | \$ 347,755 | \$ 370,767 |
| Cash, cash equivalents and marketable securities | \$ 324,227 | \$ 347,235 |

Working capital: The decrease in working capital in the six months ended June 25, 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 as well as reduced inventory levels.

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 and agency securities. 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 \$11.5 million held by our foreign subsidiaries as of June 25, 2011.

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Days Sales Outstanding: Days sales outstanding from receivables (DSO) were 53 days at June 25, 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:

| | Six months ended | |
|---|------------------|------------------|
| | June 25, 2011 | June 26, 2010 |
| | (In thousands) | |
| Cash used in operating activities | \$ (19,539) | \$ (35,820) |
| Cash provided by investing activities | 29,283 | 2,151 |
| Cash (used in) provided by financing activities | (1,431) | 1,536 |

Cash flows from operating activities: Net cash used in operating activities for the six months ended June 25, 2011 was primarily driven by the net loss of \$29.1 million, offset in part by \$11.3 million of non-cash charges consisting primarily of \$5.8 million of depreciation and amortization, \$6.3 million of stock-based compensation and \$3.5 million of provision for excess and obsolete inventories. The net change in operating assets and liabilities of \$1.8 million for the six months ended June 25, 2011 consisted primarily of a decrease of \$8.5 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 a decrease in accounts receivable of \$1.1 million due to strong cash collections in the first two quarters of fiscal 2011 as well as a \$4.7 million reduction in prepaid expenses and other current assets 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 six months ended June 26, 2010 are primarily driven by the net loss of \$72.0 million incurred during the first half of fiscal 2010 offset in part by non-cash charges consisting of \$16.9 million of depreciation and amortization, \$9.2 million of stock-based compensation and \$1.0 million of impairment of property and equipment. The net change in operating assets and liabilities for the six months ended June 26, 2010 of \$6.9 million consisted primarily of the decrease in refundable income taxes, due to the receipt of a federal income tax refund of \$26.2 million in March 2010, offset by an increase in accounts receivable due to higher revenues as well as an increase in inventories due to higher sales forecast.

Cash flows from investing activities: Net cash provided by investing activities for the six months ended June 25, 2011 was primarily related to \$144.2 million proceeds from maturities and sales of marketable securities partially offset by purchases of marketable securities totaling \$112.2 million and \$2.7 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.

The cash flows provided by investing activities for the six months ended June 26, 2010 are primarily related to \$164.2 million proceeds from maturities and sales of marketable securities offset by purchases of marketable securities totaling \$145.6 million and \$16.5 million cash used in the acquisition of property and equipment for new product technology.

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Cash flows provided by financing activities: Net cash used in financing activities for the six months ended June 25, 2011 included \$3.0 million used for the repurchase and retirement of our common stock partially offset by \$1.6 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.

The cash flows provided by financing activities for the six months ended June 26, 2010 included \$1.5 million in proceeds received from purchases under our 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.

Our cash, cash equivalents and marketable securities declined in the six months ended June 25, 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.

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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 June 25, 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

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 six months ended June 25, 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.

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.

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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 Report on Form 10-Q for the quarter ended March 26, 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 quarter ended March 26, 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.

Table of Contents**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 and expires on 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. During the second fiscal quarter of 2011 we repurchased and retired an additional 117,437 shares for \$1.0 million.

The following table summarizes our repurchases of outstanding common stock for the six months ended June 25, 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 |
| | 380,149 | \$ 8.85 | 380,149 | |

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 | | | | * |

* 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: August 3, 2011

By:

/s/ Michael M. Ludwig

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

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