FSI INTERNATIONAL INC
Form 10-K
November 12, 2009

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the fiscal year ended August 29, 2009

or

o **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the transition period from to

Commission File Number 0-17276
FSI INTERNATIONAL, INC.
(Exact Name of Registrant as specified in its charter)

MINNESOTA	**41-1223238**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

3455 LYMAN BOULEVARD, CHASKA, MINNESOTA 55318-3052
(Address of principal executive offices and Zip Code)

Registrant s telephone number, including area code: (952) 448-5440

Securities registered pursuant to Section 12(b) of the Securities Exchange Act:
Title of each class
Common Stock, no par value
Name of Exchange on which registered:
NASDAQ Global Market

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

Indicate by a check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act of 1933. Yes o No þ

Indicate by a check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Securities Exchange Act of 1934. Yes o No þ

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

Indicate by a checkmark whether the Registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T

(§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the Registrant was required to submit and post such files). Yes o No o

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Securities Exchange Act of 1934.

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

Indicate by a check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act of 1934). Yes o No þ

The aggregate market value of the voting common stock held by non-affiliates of the Registrant, based on the closing price on February 27, 2009, the last business day of the Registrant s most recently completed second fiscal quarter, as reported on the NASDAQ Global Market, was approximately $7,700,000. Shares of common stock held by each officer and director have been excluded from this computation in that such persons may be deemed to be affiliates. This amount is provided only for purposes of this report on Form 10-K and does not represent an admission by the Registrant or any such person as to the status of such person.

As of October 30, 2009, the Registrant had issued and outstanding 31,636,000 shares of common stock.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the Registrant s definitive proxy statement for the Annual Meeting of Shareholders to be held on January 20, 2010 and to be filed within 120 days after the Registrant s fiscal year ended August 29, 2009, are incorporated by reference into Part III of this Form 10-K Report. (The Audit and Finance Committee Report and the Compensation Committee Report of the Registrant s proxy statement are expressly not incorporated by reference herein.)

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PART I

Cautionary Information Regarding Forward-Looking Statements

Certain statements contained in this report on Form 10-K constitute forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and are subject to the safe harbor created by that statute. Typically we identify forward-looking statements by use of an asterisk * . In some cases, you can identify forward-looking statements by terminology such as expects, anticipates, intends, may, should, plans, believ estimates, could, would or the negative of such terms or other comparable terminology. Such forward-looking statements are based upon current expectations and beliefs and involve numerous risks and uncertainties, both known and unknown, that could cause actual events or results to differ materially from these forward-looking statements. For a discussion of factors that could cause actual results to differ materially from those described in this Form 10-K, see the discussion of risk factors set forth below in Item 1.A. of this report. Although we believe that the expectations reflected in the forward-looking statements are reasonable as of the date of this report, we cannot guarantee future results, levels of activity, performance or achievements. We undertake no duty to update any of the forward-looking statements after the date of this report.

ITEM 1. *BUSINESS*

The Company

FSI International, Inc., a Minnesota corporation organized in 1973 (FSI , the Company , we , us), designs, manufactu markets and supports equipment used in the fabrication of microelectronics, such as advanced semiconductor devices. In fiscal 2009, we provided surface conditioning technology solutions and microlithography systems and support services to worldwide manufacturers of integrated circuits. FSI manufactures, markets and supports surface conditioning equipment that uses wet, cryogenic and other chemistry techniques to clean, strip or etch the surfaces of silicon wafers and supplies refurbished microlithography products that are used to deposit and develop light sensitive films. FSI s business is supported by service groups that provide finance, human resources, information services, sales and service, marketing and other administrative functions.

FSI directly sells and services our products in North America, Europe, and the Asia Pacific region, except for Japan. In Japan, our products are sold and serviced through Apprecia Technology, Inc. (Apprecia) (formerly known as m FSI LTD), a company in which FSI maintains a 20 percent equity ownership. See Note 3 of the Notes to Consolidated Financial Statements for a discussion of our equity ownership in Apprecia.

Industry Background

The complex process of fabricating semiconductor devices involves several distinct phases that are repeated numerous times. Because each production phase typically requires different processing technologies and equipment, no single semiconductor equipment supplier currently produces all types of tools needed to equip an entire state-of-the-art fabrication facility. Instead, semiconductor device manufacturers typically equip their facilities by combining manufacturing equipment produced by a number of suppliers. Each set of equipment performs specific functions in the manufacturing process.

Generally, increasing demand for computer chips, new computer chip designs, new materials of fabrication and new substrate (the underlying material upon which a semiconductor device or integrated circuit is formed) types both size and composition drives demand for new microelectronics manufacturing equipment and processes. Industries that use microelectronics increasingly demand higher performance devices from manufacturers. Over the last decade, device manufacturers have reduced the feature size and substantially increased the functionality of individual devices through a number of technological advances. Many of these advancements are made possible using the equipment and technologies FSI provides to the semiconductor industry.

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Our business depends upon the microelectronics manufacturers capital equipment expenditures. Manufacturers expenditures in turn depend on the current and anticipated market demand for products that use microelectronic devices. The microelectronics industry is cyclical in nature and experiences periodic downturns. Microelectronics manufacturers require equipment suppliers to take an increasingly active role in meeting the manufacturers technology development and capital productivity requirements. Equipment suppliers satisfy this requirement by developing and supporting products and processes required to address the new trends in microelectronics manufacturing. These trends include development of smaller geometries, transition to new materials, migration to larger wafers and wafer level packaging.

According to Gartner, Inc., a leading semiconductor equipment industry group, purchases of semiconductor equipment by microelectronics manufacturers totaled $30.7 billion in calendar 2008. Based upon the most recent Gartner Group forecast (made in September 2009), spending on semiconductor equipment is expected to decrease by 48% to $16 billion in calendar 2009 but increase in calendar year 2010 by 39% to $22.2 billion.*

Products

The sales mix between system sales and spare parts and service sales has varied from year to year. The following table sets forth, for the periods indicated, the amount of revenues and approximate percentages of our total revenues for systems and spare parts and service:

	Fiscal Year Ended					
	August 29, 2009		August 30, 2008		August 25, 2007	
	(Dollars in thousands)					
Systems	$ 32,879	65.1%	$ 51,365	65.6%	$ 85,444	73.5%
Spare parts and service	17,605	34.9%	26,891	34.4%	30,789	26.5%
	$ 50,484	100.0%	$ 78,256	100.0%	$ 116,233	100.0%

Systems

Our surface conditioning (SC) systems perform etching and cleaning operations for:

front-end-of-line (FEOL) fabrication steps, where integrated circuits or transistors are formed in and on the substrate during the manufacturing process;

back-end-of-line (BEOL) fabrication steps, where metal wiring levels are formed on the surface of the wafer and are connected to the transistors; and

wafer-level packaging surface preparation, including cleaning, etching and stripping functions necessary to fabricate solder bumps or other terminal structures needed to connect the chip to the circuit board.

Today s most advanced integrated circuit (IC) manufacturing involves more than 100 surface preparation steps. Many factors are considered when designing and optimizing a surface preparation process to meet a particular application need. These factors can include:

cleaning and etching goals, which are related to the removal of wafer contaminants and films;

selectivity goals, which are related to leaving desired films and structures intact; and

manufacturing goals, which are related to cost, productivity, safety and environmental concerns.

The priority of each factor in determining the final surface preparation process can vary widely across the approximately 100 different steps and depends on the contaminants that need to be removed, the materials that need to be preserved on the wafer surface, the dimensions of patterned features and overall process integration. These varied requirements and priorities indicate that no single surface preparation technology can provide the optimal process for every surface preparation requirement. This is why FSI offers a range of technologies that allow us, with our customers, to select and optimize the best solution for each step. These technologies include batch and single wafer spray, batch immersion and single wafer cryogenic aerosol.

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Batch Spray Processing Systems. Our batch spray processing systems, which include the ZETA® and MERCURY® Spray Cleaning Systems, are sophisticated surface conditioning systems that remove unwanted films and contaminants from the surface of semiconductor wafers at various stages in the microelectronic device fabrication process. Multiple cassettes that contain up to 27 wafers each are placed onto a turntable inside the system s process chamber. As the turntable rotates, dispense ports apply a chemical spray to the wafers surfaces to dissolve and remove the undesirable films and contaminants. After chemical application, ultra pure water is sprayed on the wafer surfaces to rinse away the chemicals. Multiple chemical and rinse steps may be employed depending on the customer s specific application. The process sequence is completed with a drying step where a flow of nitrogen into the chamber dries the wafers and the chamber. Our control system and chemical mixing manifold allow the user to define, control and monitor a variety of chemical mixtures, temperatures and sequences. This enables the user to rapidly develop new processes and utilize the systems for multiple applications.

Our batch spray systems achieve state-of-the-art performance and are well suited for applications that require removal of high levels of contamination, such as implanted photoresist and unreacted salicide metal. Through efficient mixing and use of chemicals and water packaged in a small product footprint, customers may realize lower operational costs than with competing systems. ZETA systems are differentiated in that they dispense fresh chemicals during wafer processing as compared to wet bench systems that may use recirculated chemicals. Fresh chemical dispense leads to the lowest possible surface contamination levels, which is critical in the fabrication of advanced devices.

The ZETA® System is a fully-automated batch spray processor currently available in configurations for both 200 and 300mm wafers. The advanced process controls, process capability and automation are ideal for leading technology nodes, particularly from 90 nanometers (nm) down to 32nm and below. Our ZETA products provide a reliable, automated environment to move wafers to and from the process chamber. This tool s multi-chemical flow system allows for a wide range of chemical blend ratios. The system is also available in a lower cost semi-automated configuration capable of processing 150 or 200mm wafers.

Introduced in 2006, and offered on ZETA systems, our ViPR™ technology provides the industry with an all-wet non-ashing implanted resist strip process. Ashing is a method of stripping photoresist using an excited gas such as oxygen plasma, ozone or hydrogen-containing plasma. Ashing can cause surface damage and undesired material loss. ViPR provides a non-ashing alternative stripping methodology by raising the process chemistry temperature and reactivity higher than the traditional processes. The ViPR process is accomplished through FSI s patented steam injection chemistry.

In 2008, our ViPR technology was expanded to include stripping of unreacted metals for metal silicide process steps most notably the nickel platinum silicide process which traditionally used hazardous aqua regia chemistry. Aqua regia (a mixture of nitric acid and hydrochloric acid) is also known to attack nickel platinum silicide degrading 45 and 32nm device performance. ViPR has demonstrated its ability to efficiently strip the unreacted metals without attacking the silicide layer.

The MERCURY® System is a semi-automated batch spray processor designed for wafer sizes up to 200mm in diameter and process technologies through the 90nm node. The system has been widely adopted by the IC manufacturing industry, with nearly 1000 systems shipped to numerous customers since its introduction. Mercury systems offer the benefits of high performance cleans, etches and strips with the added advantage of low capital cost and low cost of ownership and a very small footprint.

Single Wafer Cleaning Systems. Our newest platform, the ORION® Single Wafer Cleaning System, is for cleaning 300mm semiconductor wafers in a closed chamber, single wafer environment. The ORION platform uses FSI s core technologies, including ViPR technology, in-line chemical blending, energetic aerosol chemical and water delivery, recipe driven process flexibility and closed chamber environmental control. Its small footprint modular design has the flexibility to enable clustering of different chamber types and the extendibility to add modules to increase maximum throughput. In addition to offering a highly productive and space efficient cleaning solution, the system s unique closed chamber permits control of the environment in which the wafer is processed. Benefits include elimination of water marks, reduction of oxidation and related material loss, prevention of galvanic corrosion of metal film stacks, and the use of our proprietary ViPR™ Technology to strip implanted photoresist and salicide metal residues.

Since its introduction, ORION systems have proven to enable BEOL copper / low-k interconnect cleans and accepted for 45nm and 32nm manufacturing. ORION systems are also currently being used in 22nm development activities.

CryoKinetic Processing Systems. Our ANTARES® CryoKinetic Cleaning System is a fully automated, single-wafer cleaning platform designed for 200 and 300mm wafers. CryoKinetic cleaning is a physical energy transfer process used to remove non-chemically bonded particles from the surface of a microelectronic device. These systems offer a field-proven history of removing surface particle defects and improving customer yields. The ANTARES system uses an all-dry non-chemically reactive method for removing defects from all surface types from the beginning to the end of the device manufacturing process. Of particular benefit to our customers is its inherent compatibility with new device materials and increasingly smaller device features.

CryoKinetic clean technology allows our customers to insert particle removal steps in the manufacturing line where previous or traditional wet cleaning and scrubber methods have been phased out due to their incompatibility with new materials and their propensity to cause watermark residue and surface charge defects. Implementing the CryoKinetic clean technology allows our customers to recover yield that would normally be lost where traditional approaches cannot be used, such as after in-line electrical testing of wafers. In-line testing creates debris on the wafer surface that cannot be removed with traditional cleaning methods due to the sensitivity of the exposed materials (copper and low-k dielectrics). The ANTARES clean can eliminate defects created by in-line electrical probing so IC makers can collect electrical test data without scrapping wafers.

We believe the technical capabilities of the ANTARES system are extendable well beyond current technology nodes and may result in increased customer acceptance due to the limitations of scrubbing methods.*

Immersion Processing Systems. Immersion cleaning systems are used to clean silicon wafers by immersing wafers in multiple tanks filled with process chemicals. These systems enable the implementation of high performance isopropyl alcohol (IPA) assisted drying to meet the critical cleaning requirements for 90, 65, and 45nm technology nodes. Our MAGELLAN® Immersion Cleaning System is a fully automated immersion cleaning product designed for either 200 or 300mm wafers at advanced technology nodes and is capable of multiple cleans, including critical clean, resist strip and etch. We believe this system compares favorably to competing systems through its process performance, flexibility, extendibility, and rapid cycle time in a footprint that is smaller than the leading competition when configured for specific applications. The MAGELLAN Immersion Cleaning System incorporates a portfolio of exclusive intellectual property, including our Surface Tension Gradient (STG®) rinse/dry technology, SymFlow® etch technology, ozone oxide re-growth technology, and narrow-gate-compatible MegaLens™ Acoustic Diffuser megasonic cleaning technology. The MAGELLAN System is qualified for several processes including FEOL critical clean, FEOL photoresist strip and post-ash clean, as well as oxide etch and nitride etch.

Resist Processing Systems. Our POLARIS® Microlithography System is used to deposit polyimide resist and photoresist, light-sensitive, etch-resistant materials used to transfer an image to the surface of a silicon wafer, or similar material wafer, and then bake, chill and develop the deposited material after exposure. We are focused on providing cost effective solutions to our existing base of POLARIS system customers and for specialized markets, including wafer level packaging, MEMS, and thin film media storage devices. Through our POLARIS Refresh Program™, in which customers can purchase pre-owned, certified POLARIS clusters (an integrated environmentally isolated manufacturing system consisting of process, transport, and cassette modules mechanically linked together) made of both new and/or re-manufactured modules. This allows customers to add capacity for a lower capital investment. The ratio of new to pre-owned modules is based on customer expectations and the availability of used modules. These systems are able to accommodate a variety of processes and can be purchased in a new configuration or a system can be reconfigured and upgraded to match previously installed configurations.

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Spare Parts and Service

We offer system and subsystem upgrade packages, spare part kits, individual spare part components, robot refurbishment and replacement, and support services that provide product and process enhancements to extend the life of previously purchased and installed systems. Our customer service and process engineers assist and train customers worldwide to perform preventive maintenance on, and to service, our equipment. In addition, our process engineering groups develop process applications to expand the capabilities of our equipment. These upgrade and spare part packages and support service programs enable our worldwide customers to realize a higher return on their capital investment. We sell a variety of process, service and maintenance programs. A number of customers have purchased maintenance contracts in which our service employees work at the customer s facility to provide process service and maintenance support for our equipment.

Backlog and Seasonality

Our backlog consists of customer purchase orders with delivery dates within the next 12 months. Our backlog was $7.9 million at fiscal 2009 year-end and $5.6 million at fiscal 2008 year-end. Approximately 71% of our backlog at fiscal 2009 year-end was comprised of orders from two customers. Approximately 37% of our backlog at fiscal 2008 year-end was comprised of orders from two other customers. All orders are subject to cancellation by the customer and in some cases a penalty provision could apply to a cancellation.

In fiscal 2009 and 2008, no significant purchase orders were canceled. Because of the timing and relative size of certain orders we received and possible changes in delivery schedules and order cancellations, our backlog can vary from time to time so that backlog as of any particular date is not necessarily indicative of actual sales for any subsequent period. Our business is cyclical but is not seasonal to any significant extent.

Research and Development

We believe that our future success depends in large part on our ability to enhance and advance, in collaboration with our customers and other equipment and materials manufacturers, our existing SC product lines to meet the changing needs of microelectronics manufacturers. We believe that industry trends, such as the use of smaller circuit geometries, the increased use of larger substrates and manufacturers increased desire for integrated processing equipment, will make highly automated and integrated systems, including single substrate processing systems, more important to customers. For assistance in our development efforts, we maintain relationships with our customers and industry consortium, who help identify and analyze industry trends and assess how our development activities meet the industry s advanced technology needs.

Our current research and development programs are focused on creating new processes and technologies for cleaning substrates without damaging the increasingly smaller patterned features being used for the most advanced IC devices. We are also conducting programs to increase process control and flexibility through monitoring and software management systems and process automation, robotics automation in the cleanroom, and integration of our product offerings with other suppliers products. Each of these programs involves collaboration with customers and other equipment manufacturers to ensure proper machine configuration and process development to meet industry requirements.

We maintain an 8,000-square-foot, state-of-the-art demonstration and process development laboratory for our SC business at our Chaska, Minnesota facility. In addition, we lease 6,000 square feet of laboratory and office space in Allen, Texas for process development and demonstration for our POLARIS resist processing products.

Expenditures for research and development, which are expensed as incurred, during fiscal 2009 were approximately $14.7 million, representing 29.1% of total sales. Expenditures for research and development during fiscal 2008 were approximately $19.0 million, representing 24.2% of total sales, and expenditures for research and development during fiscal 2007 were approximately $24.1 million, representing 20.7% of total sales.

We expect to continue to make substantial investments in research and development.* We also recognize the importance of managing product transitions successfully, as the introduction of new products could adversely affect sales of existing products.

Marketing, Sales and Support

We market our products worldwide to manufacturers of microelectronic devices. Our marketing and sales efforts are focused on building long-term collaborative relationships with our customers. These efforts are supported by marketing, sales, and service personnel, along with applications engineers. These worldwide FSI teams work collaboratively with individual IC manufacturers, in FSI process laboratories and at customer sites, to integrate FSI developed product and process innovations into customer process flows and optimize them according to customer priorities.

During fiscal 2009, we directly sold and serviced our products in North America, Europe and the Asia Pacific region, and through Apprecia in Japan.

By providing a full portfolio of direct support services, we are able to develop stronger customer relationships and our customers continue to show greater interest in expanding beyond their current use of our traditional spray cleaning technologies to include new FEOL and BEOL applications for batch and single wafer spray, as well as employing our advanced immersion and CryoKinetic technologies. Our increased responsiveness on the local level has resulted in more shared efforts and joint development programs with IC makers throughout the world for 65nm production and 45nm, 32nm and 22nm development projects.

Manufacturing, Raw Materials and Suppliers

We maintain manufacturing facilities in Chaska, Minnesota and Allen, Texas. We typically assemble our products and systems from components and prefabricated parts manufactured and supplied by others, including process controllers, robots, integrated circuits, power supplies, stainless steel pressure vessels, chamber bowls, valves and relays. Certain items manufactured by third parties are custom-made to our specifications. Typically, final assembly and systems tests are performed by our manufacturing personnel. Quality control is maintained through quality assurance programs with suppliers, incoming inspection of components, in-process inspection during equipment assembly, and final inspection and operation of manufactured equipment prior to shipment. We have a company-wide quality program in place and received ISO 9001 certification in 1994 and ISO 9000:2000 certification in 2003.

Certain components and subassemblies included in our products are obtained from a single supplier or a limited group of suppliers to ensure overall quality and delivery timeliness. We purchased approximately 25% of our fiscal 2009 and approximately 23% of our fiscal 2008 inventory purchases from two suppliers. We purchased approximately 10% of our fiscal 2007 inventory purchases from one supplier. Although we seek to reduce dependence on sole and limited-source suppliers, disruption or termination of certain of our inventory sources could have a temporary adverse effect on our operations. We believe that alternative sources could be obtained and qualified to supply these products, if necessary, but that production delays would likely occur in some cases.* Further, a prolonged inability to obtain certain components could have an adverse effect on our operating results, delay scheduled deliveries and result in damage to customer relationships.

Competition

The semiconductor equipment industry is very competitive and marked by continuous technological challenges. Significant competitive factors in the equipment market include system price, which encompasses total cost of ownership, quality, process performance, reliability, flexibility, extendibility, process or tool of record, and customer support.

Many of our established competitors have greater financial, engineering, research, development, manufacturing, marketing, service and support resources. To remain competitive, we must invest in research and development, marketing, customer service and support programs, and also manage our operating expenses. We cannot assure that we will have sufficient resources to continue to make these investments or that our products will continue to be viewed as competitive as a result of technological advances by existing or new competitors or due to changes in semiconductor technology.

Our products compete with, among others, the products of DaiNippon Screen Manufacturing Co. Ltd., Semitool, Inc., Lam Research, SEMES Co. LTD, Tokyo Electron Ltd. and several smaller companies. In addition, we compete with various small equipment refurbishment, equipment maintenance and spare parts providers.

Customers

We sell products from one or more of our product lines to most major microelectronics manufacturers. We have an extensive history of sales to several of the largest IC manufacturers and over 100 active customers worldwide. The following customers accounted for 10% or more of our total sales in fiscal 2009, 2008 and 2007:

Customer	**Fiscal 2009**	**Fiscal 2008**	**Fiscal 2007**
Samsung Electronics	34%	19%	13%
ST Microelectronics	u	12%	u
Intel Corporation	u	u	11%

u Customer accounted for less than 10% of our total sales during the fiscal year.

The loss of any of these customers could have a material adverse effect on our operations. We have experienced, and expect to continue to experience, fluctuations in our customer mix.* The timing of an order for our equipment is primarily dependent upon the customer s expansion program, replacement needs, or requirements to improve productivity and yields. Consequently, a customer who places significant orders in one year will not necessarily place significant orders in subsequent years.

Under the distribution agreement entered into on May 15, 2007 with Apprecia, Apprecia has exclusive distribution rights for five years with respect to our SC products in Japan. Prior to its expiration, the distribution agreement with Apprecia may be terminated only upon the occurrence of certain events or conditions or as otherwise mutually agreed. Starting in fiscal 2009, Apprecia was subject to a minimum purchase obligation. Apprecia did not achieve the minimum purchase obligation in fiscal 2009, and therefore, we have the right to terminate the agreement in accordance with its terms and conditions. We are not currently electing to terminate the agreement; however, we are reserving the right to do so in the future.

Patents, Trademarks and Intellectual Property

Our success depends upon a variety of factors, including proprietary technology. It is important to protect our technology by obtaining and enforcing patents. Consequently, we have an active program to file patent applications in the United States and other countries on inventions we consider significant. We also possess other proprietary intellectual property, including trademarks, know-how, trade secrets and copyrights. We also protect our proprietary information through confidentiality agreements with our employees and various third parties.

We have a number of patents in the United States and other countries, with additional applications pending. These patents may be challenged, invalidated or circumvented, or may not provide any competitive advantages to us. Pending applications may not result in patents and the claims allowed in future patents may not be sufficiently broad to protect our technology. The laws of some foreign countries may not permit the protection of our proprietary rights to the same extent as under the laws of the United States. We believe that the protections afforded by our patents, patent applications, and other intellectual property rights have value. Because of rapidly changing technology, our future success depends on the know-how of our employees.

In the normal course of business, we occasionally receive and make inquiries about possible patent infringement. In dealing with such inquiries, it may be necessary or useful for us to obtain or grant licenses or other rights. However, we cannot assure that such license rights will be available to us on commercially

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reasonable terms, or even at all. The inability to obtain certain license or other rights, or to obtain such licenses or rights on favorable terms, or the need to engage in litigation could have a material adverse effect on us.

We offer our POLARIS system pursuant to a non-exclusive license from Texas Instruments Incorporated (TI). We have converted the license to a fully paid-up, worldwide license to sell and manufacture the POLARIS system. We also have the non-exclusive right to manufacture and sell related TI modules. The license agreement with TI continues until terminated by either party upon a breach by the other, and the failure to cure, in accordance with the terms of the agreement.

We offer our ANTARES CX Cleaning System under license agreements from IBM Corporation. The licenses require certain minimum and system-based royalties. Royalties are based on the royalty portion revenues of licensed equipment that excludes amounts for freight, taxes, customers duties, insurance, discounts, and certain equipment not manufactured by us.

As of August 29, 2009, we had 76 U.S. patents. Expiration dates for these patents range from January 2010 to February 2027. In addition, we have 19 pending U.S. patent applications in various stages of the patent examination process.

Employees

As of August 29, 2009, we had 255 full and part-time employees. Competition for highly skilled employees is intense. We believe that a great part of our future success depends upon our continued ability to retain and attract qualified employees. We are not subject to any collective bargaining agreements in the United States and have never been subject to a work stoppage. We are subject to collective bargaining agreements in Italy and France covering approximately 10 employees. We have never been subject to a work stoppage in Italy or France.

Environmental Matters

In January 2003, we received our certificate of registration from BSI Management Systems, an independent business services organization that certifies management systems and products, for its ISO 14001 environmental management system. ISO 14001 is an internationally recognized environmental management standard that empowers organizations to address the environmental impact of its activities, services and processes. The standard then provides a framework for enterprises to take steps to identify issues significant to them and implement environmental management programs to achieve improved performance. Registration with ISO 14001 allows companies to reaffirm that environmental processes are essential components of their business strategy. We have a long history of environmentally-friendly practices including research and development programs that actively seek ways to operate more environmentally efficient. We registered with ISO 14001 to emphasize our ongoing commitment to the preservation and protection of the environment, and to support existing environmental health and safety initiatives.

We implemented an enterprise-wide program to actively engage our employees to develop ways to, and emphasize the importance of, protecting the environment in everyday life at FSI. Our programs include recycling, water use reductions, chemical handling processes and equipment design for the environment.

We are subject to a variety of governmental regulations related to the discharge or disposal of toxic, volatile or otherwise hazardous chemicals used in the manufacturing and product development process. We believe that we are in compliance with these regulations and that we have obtained all necessary environmental permits to conduct our business. These permits generally relate to the disposal of hazardous wastes. If we fail to comply with present or future regulations, fines could be imposed, production and product development could be suspended, or operations could cease. Such regulations could require us to acquire significant equipment or take other actions necessary to comply with environmental regulations at a potentially significant cost. If we fail to control the use of, or adequately restrict the discharge and disposal of, hazardous substances, we could incur future liabilities.

We believe that compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, will not have a material effect upon our capital expenditures, earnings or competitive position.*

International Sales

International sales accounted for approximately 71% of total sales in fiscal 2009, 76% of total sales in fiscal 2008, and 69% of total sales in fiscal 2007. Additional information on our international sales for each of the last three fiscal years is disclosed in Note 14 to the consolidated financial statements included in Item 8 of this report.

Available Information

Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Exchange Act of 1934 are available free of charge on our website at www.fsi-intl.com as soon as reasonably practicable after such reports have been filed with or furnished to the Securities and Exchange Commission. The public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 100 F Street, NE, Washington, DC 20549, on official business days during the hours of 10:00 am to 3:00 pm. The public may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330. The SEC maintains an Internet site, http://www.sec.gov, that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC.

Item 1.A. *Risk Factors*

Our business faces significant risks. The risks described below are not the only risks we face. Additional risks and uncertainties not presently known to us or that we currently believe are immaterial also may impair our business operations. If any of the events or circumstances described in the following risks occurs, our business, operating results or financial condition could be materially adversely affected. The following risk factors should be read in conjunction with the other information and risks set forth in this report.

If the economic environment does not improve in early fiscal 2010 and, notwithstanding our cash management initiatives, more cash is needed to fund operations than expected, we may need to take additional actions.

In light of our financial condition, we implemented a number of cost reduction steps in fiscal 2009 to reduce our use of cash, as discussed in Note 17 of the Notes to Condensed Consolidated Financial Statements. Our cost reduction actions in fiscal 2009 are expected to lower our annual operating expenses by $11 to $12 million, which is expected to reduce our cash flow breakeven revenue level to approximately $12 to $14 million per quarter, depending on the gross margins and the timing of shipments and accounts receivable collections.* In addition, we plan to manage cash flows by reducing capital expenditures to less than $500,000 in fiscal 2010 and to aggressively improve our working capital levels in the second half of fiscal 2010.* We believe that these actions will allow us to have sufficient cash to fund our operations through at least fiscal 2010.*

We do not have any revolving line of credit or other form of debt financing. If the economic environment does not improve in early fiscal 2010 and, notwithstanding our cash management initiatives, more cash is needed to fund operations than expected, we may need to take additional actions.* These actions could include additional cost reduction measures and possible cash generating activities, including exploring a sale-leaseback arrangement for our Chaska, Minnesota facility, entering into an asset-based lending arrangement, borrowing up to $3.2 million against or liquidating our remaining life insurance investments of $3.5 million, borrowing up to 50% against or selling some or all of our currently illiquid auction rate securities (ARS), possibly at a loss, or selling additional equity.* We can provide no assurance that any of these cash-generating activities will be available to us when needed, or if available, on such terms that will be acceptable or in sufficient amounts to cover our operating expenses at such time. The sale of additional equity would likely result in

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additional dilution to our shareholders.* In addition, without substantial available capital, we may be unable to take advantage of strategic opportunities as they arise, such as investments in or acquisitions of businesses, products or technologies.*

If the worsening of credit market conditions continues or increases, it could have a material adverse impact on our investment portfolio.

The current short-term funding credit issues that began to occur during the second half of calendar 2007, continue to impact liquidity in asset-backed commercial paper and to cause failed auctions in the auction rate market. If the global credit market continues to deteriorate, our investment portfolio may be impacted and we could determine that some of our investments are impaired. This could materially adversely impact our results of operations and financial condition.

Our investment portfolio includes ARS. The ARS we currently hold have contractual maturities between 26 to 34 years. ARS are usually found in the form of municipal bonds, preferred stock, a pool of student loans or collateralized debt obligations. The interest rates of our ARS are reset every 28 days through an auction process and at the end of each reset period, investors can sell or continue to hold the securities at par.

The $4.7 million par value ARS we hold are backed by student loans and are collateralized, insured and guaranteed by the United States Federal Department of Education. In addition, all ARS held by us are rated by the major independent rating agencies and carry investment grade ratings and have not experienced any payment defaults.

Beginning in the second quarter of fiscal 2008, all of our ARS experienced failed auctions due to sell orders exceeding buy orders. Under the contractual terms, the issuer is obligated to pay penalty interest rates should an auction fail. We cannot liquidate our ARS until a successful auction occurs, the issuer redeems the ARS, a buyer is found outside of the auction process or the underlying securities have matured.

We recorded an other than temporary impairment of approximately $0.4 million as of August 30, 2008 related to our ARS . During fiscal 2009, we redeemed $3.0 million par value of ARS for $3.0 million and we recorded a gain of $0.1 million, which reversed the previously recorded impairment related to these securities.

There is no assurance that future auctions of our ARS will be successful. As a result, our ability to voluntarily liquidate and recover the carrying value of some or all of the ARS we hold may be limited for an indefinite period of time. If an issuer of our ARS is unable to successfully close future auctions or does not redeem the ARS, or the United States government fails to support its guaranty of the obligations, we may be required to adjust the carrying value of the ARS and record additional impairment charges in future periods, which could materially affect our results of operations and financial condition.

Because our business depends on the amount that manufacturers of microelectronics spend on capital equipment, downturns in the microelectronics industry may adversely affect our results.

The microelectronics industry experiences periodic downturns, which may have a negative effect on our sales and operating results. Our business depends on the amounts that manufacturers of microelectronics spend on capital equipment. The amounts they spend on capital equipment depend on the existing and expected demand for semiconductor devices and products that use semiconductor devices. When a downturn occurs, some semiconductor manufacturers experience lower demand and increased pricing pressure for their products. As a result, they are likely to purchase less semiconductor processing equipment and have sometimes delayed making decisions to purchase capital equipment. In some cases, semiconductor manufacturers have canceled or delayed orders for our products. Typically, the semiconductor equipment industry has experienced more pronounced decreases in net sales than the semiconductor industry as a whole.

Since early calendar 2007, we, along with others in the semiconductor equipment industry, have experienced a downturn in orders for new equipment as well as delays in existing orders, primarily from logic and flash memory manufacturers. We cannot predict the extent and length of the current downturn in orders and the overall softening in the industry in these segments. In addition:

- the semiconductor equipment industry may experience other, possibly more severe and prolonged, downturns in the future;
- any future recovery of the microelectronics industry may not result in an increased demand by semiconductor manufacturers for capital equipment or our products; and
- the semiconductor equipment industry may not improve in the near future or at all.

Our licensing practices related to international spare parts sales may subject us to fines and could reduce our ability to be competitive in certain countries.

In addition to offering our customers microelectronics manufacturing equipment, we provide replacement spare parts, spare part kits and assemblies. In late calendar 2006, we determined that certain of our replacement valves, pumps and heaters could fall within the scope of United States export licensing regulations to products that could be used in connection with chemical weapons processes. We determined that these regulations require us to obtain licenses to ship some of our replacement spare parts, spare part kits and assemblies to customers in certain controlled countries as defined in the export licensing regulations. During the second quarter of fiscal 2007, we were granted licenses to ship replacement spare parts, spare parts kits and assemblies to all customers in the controlled countries where we currently conduct business.

The applicable export licensing regulations frequently change. Moreover, the types and categories of products that are subject to export licensing are often described in the regulations in general terms and could be subject to differing interpretations.

In the second quarter of fiscal 2007, we made a voluntary disclosure to the United States Department of Commerce to clarify our licensing practices and to review our practices with respect to prior sales of certain replacement valves, pumps and heaters to customers in several controlled countries as defined in the licensing regulations.

In October 2009, we entered into a settlement agreement with the Office of Export Enforcement for $450,000. We will pay $5,000 per month for ten months beginning in November 2009. The remaining $400,000 owed under the settlement will be suspended for 12 months. If we do not commit any export violations during the 12-month period, we will be released from further payment, including the suspended $400,000.

Failure of our products to gain market acceptance would adversely affect our financial condition.

We believe that our growth prospects depend upon our ability to gain customer acceptance of our products and technology, particularly newly developed products. Market acceptance of products depends upon numerous factors, including:

- compatibility with existing manufacturing processes and products;
- ability to displace incumbent suppliers or processes or tools of record;
- perceived advantages over competing products; and
- the level of customer service available to support such products.

Moreover, manufacturers often rely on a limited number of equipment vendors to meet their manufacturing equipment needs. As a result, market acceptance of our products may be affected adversely to the extent potential customers utilize a competitor s manufacturing equipment. There can be no assurance that sales of new products will remain constant or grow or that we will be successful in obtaining broad market acceptance of our systems and technology.

We expect to spend a significant amount of time and resources to develop new systems and enhance existing systems. In light of the long product development cycles inherent in our industry, we will make these expenditures well in advance of the prospect of deriving revenue from the sale of any new systems. Our ability to commercially introduce and successfully market any new systems is subject to a wide variety of challenges during this development cycle, including start-up bugs, design defects and other matters that could delay introduction of these systems to the marketplace. In addition, since our customers are not obligated by long-term contracts to purchase our systems, our anticipated product orders may not materialize or orders that do materialize may be canceled. As a result, if we do not achieve market acceptance of new products, we may not be able to realize sufficient sales of our systems in order to recoup research and development expenditures. The failure of any of our new products, for example the ORION®, to achieve market acceptance would harm our business, financial condition, and results of operations and cash flows.

If we do not continue to develop new products and processes, we will not be able to compete effectively.

Our business and results of operations could decline if we do not develop and successfully introduce new or improved products and processes that the market accepts. The technology used in microelectronics manufacturing equipment and processes changes rapidly. Industry standards change constantly and equipment manufacturers frequently introduce new products and processes. We believe that microelectronics manufacturers increasingly rely on equipment manufacturers like us to:

- design and develop more efficient manufacturing equipment;
- design and implement improved processes for microelectronics manufacturers to use; and
- make their equipment compatible with equipment made by other equipment manufacturers.

To compete, we must continue to develop, manufacture, and market new or improved products and processes that meet changing industry standards. To do this successfully, we must:

- select appropriate products;
- design and develop our products efficiently and quickly;
- implement our manufacturing and assembly processes efficiently and on time;
- make products that perform well for our customers;
- market and sell our products effectively; and
- introduce our new products in a way that does not unexpectedly reduce sales of our existing products.

Product or process development problems could harm our results of operations.

Our products are complex, and from time to time have defects or bugs that are difficult and costly to fix. This can harm our results of operations in the following ways:

- we may incur substantial costs to ensure the functionality and reliability of products early in their life cycle;
- repeated defects or bugs can reduce orders, increase manufacturing costs, adversely impact working capital and increase service and warranty expenses; and

we may require significant lead times between product introduction and commercialization.

As a result, we may have to write off inventory and other assets related to products and could lose customers and revenue. There is no assurance that we will be successful in preventing product and process development problems that could potentially harm our results of operations.

It may be difficult for us to compete with stronger competitors resulting from industry consolidation.

In the past several years, we have seen a trend toward consolidation in the microelectronics equipment industry. We expect the trend toward consolidation to continue as companies seek to strengthen or maintain their market positions in a rapidly changing industry.* We believe that industry consolidations may result in

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competitors that are better able to compete. This could have a significant negative impact on our business, operating results, and financial condition.

Future acquisitions may dilute our shareholders ownership interests and have other adverse consequences.

Because of consolidations in the semiconductor equipment industry we serve and other competitive factors, our management will seek to acquire additional product lines, technologies, and businesses if suitable opportunities develop. Acquisitions may result in the issuance of our stock, which may dilute our shareholders ownership interests and reduce earnings per share. Acquisitions also may increase debt levels and the related goodwill and other intangible assets, which could have a significant negative effect on our financial condition and operating results. In addition, acquisitions involve numerous risks, including:

difficulties in absorbing the new business, product line, or technology;

diversion of management s attention from other business concerns;

entering new markets in which we have little or no experience; and

possible loss of key employees of the acquired business.

Because of the volatility of our stock price, the ability to trade FSI shares may be adversely affected and our ability to raise capital through future equity financing may be reduced.

Our stock price has been volatile in the past and may continue to be so in the future. In fiscal 2009, our stock price ranged from $0.20 to $1.21 per share. In fiscal 2008, our stock price ranged from $1.08 to $2.73 per share and in fiscal 2007, our stock price ranged from $2.13 to $6.90 per share.

The trading price of our common shares is subject to wide fluctuations in response to various factors, some of which are beyond our control, including factors discussed elsewhere in this report, and the following:

failure to meet the published expectations of securities analysts for a given period;

changes in financial estimates by securities analysts;

press releases or announcements by, or changes in market values of, comparable companies;

additions or departures of key personnel; and

involvement in or adverse results from litigation.

The prices of technology stocks, including ours, have been particularly affected by extreme fluctuations in price and volume in the stock market generally. These broad stock market fluctuations may have a negative effect on our future stock price.

In the past, securities class action litigation has often been brought against a company following periods of volatility in the market price of its securities. In the future we could be the target of this type of litigation. Securities litigation may result in substantial costs and divert management s attention and resources, which could seriously harm our business.

Our common stock is at risk for delisting from the NASDAQ Global Market. If it is delisted, our stock price and the liquidity of our common stock may be impacted.

While our stock price has recently exceeded $1.00 per share, our stock price has traded below $1.00 during fiscal 2009. If, in the future, the bid price falls below $1.00 for 30 consecutive business days, we could receive notice from the NASDAQ Global Market stating that the bid price of our common stock had closed below the minimum $1.00 per share requirement for continued inclusion on the NASDAQ Global Market under Marketplace Rule 4310(c)(4). Under NASDAQ Marketplace Rule 4310(c)(8)(D), we would then have 180 calendar days to regain compliance. If at any time after receiving the notice, the bid price of our common stock closes at $1.00 per share or more for a minimum of 10 consecutive business days, the NASDAQ Global

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Market would notify us that we have achieved compliance with the minimum bid price rule. However, if we did not regain compliance with the minimum bid price rule within the 180 calendar days, the NASDAQ Global Market would determine whether we met the initial listing criteria for the NASDAQ Capital Market other than the bid price requirement. If we met such criteria, we would be afforded an additional 180 calendar days in order to regain compliance with the minimum bid price rule.

If we fail to meet NASDAQ s maintenance criteria, our common stock will be delisted from the NASDAQ Global Market.

If we fail to maintain the standards necessary to be quoted on the NASDAQ Global Market and our common stock is delisted, trading in our common stock would be conducted on the NASDAQ Capital Market or other available market, provided we meet the standards of such market. Our stock price, as well as the liquidity of our common stock, may be adversely impacted as a result.

Because our quarterly operating results are volatile, our stock price could fluctuate.

In the past, our operating results have fluctuated from quarter to quarter and are likely to do so in the future. These fluctuations may have a significant impact on our stock price. The reasons for the fluctuations in our operating results, such as sales, gross profits, and net loss, include:

The Timing of Significant Customer Orders and Customer Spending Patterns. During industry downturns, our customers may ask us to delay or even cancel the shipment of equipment orders. Delays and cancellations may adversely affect our operating results in any particular quarter if we are unable to recognize revenue for particular sales in the quarter in which we expected those sales.

The Timing of Customer Acceptances. Based on our revenue recognition policy, certain shipments to customers are not recognized until customer acceptance. Delays of customer acceptances may adversely affect our operating results in any particular quarter if we are unable to recognize revenue for particular sales in the quarter in which we expected those sales.

The Timing of New Product and Service Announcements By Us or Our Competitors. New product announcements by us or our competitors could cause our customers to delay a purchase or to decide to purchase products of one of our competitors which would adversely affect our revenue and, therefore, our results of operations. New product announcements by others may make it necessary for us to reduce prices on our products or offer more service options, which could adversely impact operating margins and net income.

The Mix of Products Sold and the Market Acceptance of Our New Product Lines. The mix of products we sell varies from period to period, and because margins vary among or within different product lines, this can adversely affect our results of operations. If we fail to sell products that generate higher margins, our average gross margins may be lower than expected. If we fail to sell our new product lines, our revenue may be lower than expected.

General Global Economic Conditions or Economic Conditions in a Particular Region. When economic conditions in a region or worldwide worsen, customers may delay or cancel their orders. There also may be an increase in the time it takes to collect payment from our customers or even outright payment defaults. This can negatively affect our cash flow and our results.

As a result of these factors, our future operating results are difficult to predict. Further, we base our current and future expense plans in significant part on our expectations of our longer-term future revenue. As a result, we expect our expense levels to be relatively fixed in the short-run. An unanticipated decline in revenue for a particular quarter may disproportionately affect our net income in that quarter. If our revenue is below our projections, then our operating results will also be below expectations. Any one of the factors we list above, or a combination of them, could adversely affect our quarterly results of operations, and consequently may cause a decline in our share price.

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Changes in demand caused by fluctuations in foreign currency exchange rates may reduce our international sales.

Almost all of our direct international sales are denominated in U.S. dollars. Nonetheless, changes in demand caused by fluctuations in interest and currency exchange rates may affect our international sales. We have direct sales, service and applications support and logistics responsibilities for our products in Europe and the Asia Pacific region, and accordingly, we incur labor, service and other expenses in foreign currencies. As of August 29, 2009, we had not entered into any hedging activities and our foreign currency transaction gains and losses for fiscal 2009 were insignificant. We intend to evaluate various hedging activities and other options to minimize fluctuations in foreign currency exchange rates. There is no assurance that we will be successful in minimizing foreign exchange rate risks and such failure may reduce our international sales or negatively impact our operating results.

Because of the need to meet and comply with numerous foreign regulations and policies, the potential for change in the political and economic environments in foreign jurisdictions and the difficulty of managing business overseas, we may not be able to sustain our historical level of international sales.

We operate in a global market. In fiscal 2009, approximately 71% of our sales revenue derived from sales outside of the United States. In fiscal 2008, approximately 76% of our sales revenue derived from sales outside the United States. In fiscal 2007, approximately 69% of our sales revenue derived from sales outside the United States. We expect that international sales will continue to represent a significant portion of total sales.* Sales to customers outside the United States involve a number of risks, including the following:

- imposition of government controls;
- compliance with U.S. export laws and foreign laws;
- political and economic instability;
- trade restrictions;
- changes in taxes and tariffs;
- longer payment cycles;
- difficulty of administering business overseas; and
- general economic conditions.

In particular, the Japanese and Asia Pacific markets are extremely competitive. The semiconductor device manufacturers located in these markets are very aggressive in seeking price concessions from suppliers, including equipment manufacturers like us.

We seek to meet technical standards imposed by foreign regulatory bodies. However, we cannot guarantee that we will be able to comply with those standards in the future. Any failure by us to design products to comply with foreign standards could have a significant negative impact on us.

Because of the significant financial resources needed to offer a broad range of products, to maintain customer service and support and to invest in research and development, we may be unable to compete with larger, better established competitors.

The microelectronics equipment industry is highly competitive. We face substantial competition throughout the world. We believe that to remain competitive, we will need significant financial resources to offer a broad range of products, to maintain customer service and support, and to invest in research and development. We believe that the microelectronics industry is becoming increasingly dominated by large manufacturers who have the resources to support customers on a worldwide basis. Some of our competitors have substantially greater financial, marketing, and customer-support capabilities than us. Large equipment manufacturers have or may enter the market areas in which we compete. In addition, smaller, emerging microelectronics equipment companies provide innovative technology. We expect that our competitors will continue to improve

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the design and performance of their existing products and processes. We also expect them to introduce new products and processes with better performance and pricing. We cannot guarantee that we will continue to compete effectively in the United States or elsewhere. We may be unable to continue to invest in marketing, research and development and engineering at the levels we believe necessary to maintain our competitive position. Our failure to make these investments could have a significant negative impact on our business, operating results and financial condition.

Manufacturing interruptions or delays could affect our ability to meet customer demand, while the failure to estimate customer demand accurately could result in excess or obsolete inventory.

Our business depends on our ability to supply equipment, services and related products that meet the rapidly changing requirements of our customers, which depends in part on the timely delivery of parts, components and subassemblies (collectively, parts) from suppliers. Some key parts may be subject to long lead-times and/or obtainable only from a single supplier or limited group of suppliers. Significant interruptions of manufacturing operations or the delivery of services could result in delayed deliveries to our customers, manufacturing inefficiencies, increased costs or order cancellations as a result of:

- the failure or inability of suppliers to timely deliver quality parts;
- volatility in the availability and cost of materials;
- difficulties or delays in obtaining required export approvals;
- information technology or infrastructure failures;
- difficulties related to planning or effecting business process changes;
- natural disasters (such as earthquakes, floods or storms); or
- other causes (such as regional economic downturns, pandemics, political instability, terrorism or acts of war).

Moreover, if actual demand for our products is different that expected, we may purchase more/fewer parts than necessary or incur costs for canceling, postponing or expediting delivery of parts. Any or all of these factors could materially and adversely affect our business, financial condition and results of operations.

Because we do not have long-term sales commitments with our customers, our results will be adversely affected if customers decide to reduce, delay or cancel orders or choose to deal with our competitors.

If our significant customers reduce, delay, or cancel orders, then our operating results could suffer. Our largest customers have changed from year to year, however, sales to our top five customers accounted for approximately 55% of total revenues in fiscal 2009, 51% of total revenues in fiscal 2008 and 42% of total revenues in fiscal 2007. Samsung Electronics accounted for approximately 34% of our total sales in fiscal 2009, 19% of our total sales in fiscal 2008 and 13% of our total sales in fiscal 2007. ST Microelectronics accounted for approximately 12% of our total sales in fiscal 2008. Intel Corporation accounted for approximately 11% of our total sales in fiscal 2007. We currently have no long-term sales commitments with any of our customers. Instead, we generally make sales under purchase orders. All orders are subject to cancellation or delay by the customer.

Our backlog may not result in future net sales.

We schedule the production of our systems based in part upon order backlog. Due to possible customer changes in delivery schedules and cancellations of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period. In addition, while we evaluate each customer order on a case by case basis to determine qualification for inclusion in backlog, there can be no assurance that amounts included in backlog ultimately will result in future sales. A reduction in backlog during any particular period, or the failure of our backlog to result in future sales, could harm our business.

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Because we depend upon our management and technical personnel for our success, the loss of key personnel could place us at a competitive disadvantage.

Our success depends to a significant extent upon our management and technical personnel. The loss of a number of these key persons could have a negative effect on our operations. Competition is high for such personnel in our industry in all of our locations. We periodically review our compensation and benefit packages to ensure that they are competitive in the marketplace and make adjustments or implement new programs for that purpose, as appropriate. We cannot guarantee that we will continue to attract and retain the personnel we require.

Our employment costs in the short-term are to a large extent fixed, and therefore any unexpected revenue shortfall could adversely affect our operating results.

Our operating expense levels are based in significant part on our headcount, which generally is driven by longer-term revenue goals. For a variety of reasons, particularly the high cost and disruption of lay-offs and the costs of recruiting and training, our headcount in the short-term is, to a large extent, fixed. Accordingly, we may be unable to reduce employment costs in a timely manner to compensate for any unexpected revenue or gross margin shortfall, which could have a material adverse effect on our operating results.

Because our intellectual property is important to our success, the loss or diminution of our intellectual property rights through legal challenge by others or from independent development by others, could adversely affect our business.

We attempt to protect our intellectual property rights through patents, copyrights, trade secrets, and other measures. However, we believe that our financial performance will depend more upon the innovation, technological expertise, and marketing abilities of our employees than on such protection. In connection with our intellectual property rights, we face the following risks:

our pending patent applications may not be issued or may be issued with more narrow claims;

patents issued to us may be challenged, invalidated, or circumvented;

rights granted under issued patents may not provide competitive advantages to us;

foreign laws may not protect our intellectual property rights; and

others may independently develop similar products, duplicate our products, or design around our patents.

As is typical in the semiconductor industry, we occasionally receive notices from others alleging infringement claims. We have been involved in patent infringement litigation in the past and we could become involved in similar lawsuits or other patent infringement claims in the future. We cannot guarantee the outcome of such lawsuits or claims, which may have a significant negative effect on our business or operating results.

We are currently exposed to various risks related to legal proceedings or claims.

We have in the past and may in the future be involved in legal proceedings or claims regarding patent infringement, intellectual property rights, contracts and other matters. These legal proceedings and claims, whether with or without merit, could be time-consuming and expensive to prosecute or defend, and could divert management s attention and resources. There can be no assurance regarding the outcome of future legal proceedings or claims. If we are not able to resolve a claim, negotiate a settlement of the matter, obtain necessary licenses on commercially reasonable terms and/or successfully prosecute or defend its position, our business, financial condition and results of operations could be materially and adversely affected.

We generate minor amounts of liquid and solid hazardous waste and use licensed haulers and disposal facilities to ship and dispose of such waste. In the past, we have received notice from state or federal enforcement agencies that we are a potentially responsible party (PRP) in connection with the investigation of several hazardous waste disposal sites owned and operated by third parties. In each matter, we have elected to participate in settlement offers made to all *de minimis* parties with respect to such sites. The risk of being named a PRP is that if any of the other PRPs are unable to contribute their proportionate share of the liability, if any, associated with the site, those PRPs that are financially able could be held financially responsible for the shortfall.

There has and continues to be substantial litigation regarding patent and other intellectual property rights in the microelectronics industry. Commercialization of new products or further commercialization of our current products could provoke claims of infringement by third parties. In the future, litigation may be necessary to enforce patents issued to us, to protect trade secrets or know-how owned by us or to defend us against claimed infringement of the rights of others and to determine the scope and validity of our proprietary rights. Any such litigation could result in substantial costs and diversion of our effort, which alone could have a material adverse impact on our financial condition and operating results. Further, adverse determinations in such litigation could result in our loss of proprietary rights, subject us to significant liabilities to third parties, require us to seek licenses from third parties or prevent us from manufacturing or selling one or more products, any of which could have a material adverse effect on our financial condition and results of operations.

Certain of our product lines are intended for use with hazardous chemicals. As a result, we are notified by our customers from time to time of incidents involving our equipment that have resulted in a spill or release of a hazardous chemical. We maintain product liability insurance in an effort to minimize our risk. However, in some cases it may be alleged that we or our equipment are at fault. There can be no assurance that any future litigation resulting from such claims would not have a material adverse effect on our business or financial results.

Our sales cycle is long and unpredictable, which could require us to incur high sales and marketing expenses with no assurance that a sale will result.

Sales cycles for some of our products can run as long as 12 to 18 months. As a result, we may not recognize revenue from efforts to sell particular products for extended periods of time. We believe that the length of the sales cycle may increase as some current and potential customers centralize purchasing decisions into one decision-making entity. We expect this may intensify the evaluation process and require us to make additional sales and marketing expenditures with no assurance that a sale will result.

We do not intend to pay dividends.

We have never declared or paid any cash dividends on our common stock. We currently intend to retain any future earnings for funding growth and, therefore, do not expect to pay any dividends in the foreseeable future.

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

We do not have any unresolved staff comments.

ITEM 2. ***PROPERTIES***

We own a 197,000-square-foot facility in Chaska, Minnesota. The facility contains certain product engineering, manufacturing, sales, administrative and support functions. It includes a research laboratory and 40,000 square feet of Class 1,000 and 10,000 cleanroom space, manufacturing support operations and a customer training center.

In February 2005, we sold our 162,000 square foot facility in Allen, Texas. We currently have a sublease for approximately 8,000 square feet of space in the facility. The lease expires on September 1, 2011.

We also maintain small leased sales and service offices throughout Europe and Asia near our customer locations.

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ITEM 3. *LEGAL PROCEEDINGS*

We are not subject to any material pending legal proceedings.

ITEM 4. *SUBMISSION OF MATTERS TO A VOTE OF SHAREHOLDERS*

There were no matters submitted to a vote of shareholders during the fourth quarter ended August 29, 2009.

ITEM 4A. *EXECUTIVE OFFICERS OF THE COMPANY*

The executive officers are elected by the board of directors, generally for a term of one year, and serve until their successor is elected and qualified. The following table and discussion contains information regarding our current executive officers.

Name	Age	Position
John C. Ely(1)	50	Vice President, Global Sales and Service
Patricia M. Hollister(2)	49	Chief Financial Officer and Assistant Secretary
Donald S. Mitchell(3)	54	Chairman and Chief Executive Officer
Benno G. Sand(4)	55	Executive Vice President, Business Development and Investor Relations and Secretary

(1) John Ely was named Vice President of Global Sales, Marketing and Service in March 2009. He previously served as Executive Vice President of Global Sales and Service from May 2003 to March 2009. Mr. Ely was the Executive Vice President; President, of our SC Division from August 2000 to June 2003. Mr. Ely was the SC Division s Sales/ Marketing/Applications Manager from 1997 to 2000; General Manager from 1995 to 1997; Product Specialist/Product Manager from 1989 to 1995; and in direct sales from 1985 to 1989. Prior to joining FSI, Mr. Ely was in sales and served as the Western Territory Manager of Galtek, a subsidiary of Entegris, Inc. Mr. Ely is a director of SCD Mountain View, Inc., one of our subsidiaries.

(2) Patricia Hollister has served as Chief Financial Officer since January 1998 and as Assistant Secretary since January 2000. She was our Corporate Controller from March 1995 to January 1998. Prior to joining FSI, Ms. Hollister was employed by KPMG LLP in Minneapolis, Minnesota where she served over 12 years on various audit and consulting engagements, most recently as a Senior Manager. Ms. Hollister is a director of various FSI-owned foreign subsidiaries as well as NVE Corporation.

(3) Donald Mitchell was named Chief Executive Officer and President of FSI in December 1999, was appointed a director of FSI in March 2000 and became Chairman of the Board of Directors for FSI in January 2002. From its formation in 1998 until December 1999, he was President of Air Products Electronic Chemicals, Inc., a division of Pennsylvania-based Air Products and Chemicals, Inc. From 1991 to 1998, he served as President of Schumacher, a leading global chemical equipment and services supplier to the semiconductor industry. Throughout his career with Schumacher, he held various executive positions, including Vice President of Operations and Vice President of Sales and Marketing. Mr. Mitchell is a director of FSI. Mr. Mitchell served as the 1999/2000 Chairman of the Board of Directors for Semiconductor Equipment and Materials International, a leading global industry trade association and was a member of the Board until July 2005.

(4) Benno Sand has served as Executive Vice President, Business Development and Investor Relations since January 2000. He has served as Executive Vice President since January 1992 and Secretary since March 2002. Mr. Sand also served as Chief Administrative Officer from January 1998 to December 1999, as Chief Financial Officer from October 1990 to January 1998, and as Vice President of Finance from October 1987 to January 1992. Mr. Sand is a director of various FSI-owned United States and foreign subsidiaries, as well as Apprecia, MathStar, Inc. and Digitiliti, Inc.

PART II

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ITEM 5. *MARKET FOR THE REGISTRANT S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS*

Our common stock is traded on the NASDAQ Global Market[sm] under the symbol FSII . The following table sets forth the highest and lowest daily sale prices, as reported by the NASDAQ Global Market for the fiscal periods indicated:

	2009		2008	
	High	**Low**	**High**	**Low**
Fiscal Quarter				
First	$ 1.21	$ 0.31	$ 2.73	$ 1.70
Second	0.54	0.25	2.02	1.52
Third	0.55	0.20	1.82	1.25
Fourth	0.99	0.32	1.74	1.08

There were approximately 475 record holders of our common stock on October 30, 2009.

We have never declared or paid cash dividends on our common stock. We currently intend to retain all earnings for use in our business and do not anticipate paying dividends in the foreseeable future.*

ITEM 6. *SELECTED CONSOLIDATED FINANCIAL DATA*

The table that follows presents portions of our consolidated financial statements and are not complete. You should read the following selected consolidated financial data in conjunction with our Consolidated Financial Statements and with Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this report. The Consolidated Statement of Operations data for the years ended August 29, 2009, August 30, 2008 and August 25, 2007, and the Consolidated Balance Sheet data as of August 29, 2009 and August 30, 2008, are derived from our audited consolidated financial statements, which are included elsewhere in this report. The Consolidated Statements of Operations data for the years ended August 26, 2006 and August 27, 2005 and the Consolidated Balance Sheet data as of August 25, 2007, August 26, 2006 and August 27, 2005 are derived from our audited consolidated financial statements which do not appear in this report. We changed our accounting for stock compensation expense effective August 28, 2005 in accordance with Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payment.

The historical results presented below are not necessarily indicative of the results to be expected for any future fiscal year or fiscal period.

Selected Historical Financial Data

	Fiscal Year Ended				
	August 29, 2009(5)(9)	**August 30, 2008(5)(8)**	**August 25, 2007(5)(7)**	**August 26, 2006(5)**	**August 27, 2005**
	(In thousands, except per share amounts)				
Consolidated Statements of Operations Data:					
Sales	$ 50,484	$ 78,256	$ 116,233	$ 113,241	$ 86,370

Gross margin(1)	16,427	32,985	47,123	52,850	39,994
Selling, general, and administrative expenses	19,504	29,012	34,542	36,218	35,291
Research and development expenses	14,674	18,962	24,086	24,321	22,078
Gain on sale of facility(2)					7,015
Operating loss	(17,751)	(14,989)	(11,505)	(7,689)	(10,360)
Gain on sale of marketable securities/(impairment of investments)(3)(4)(6)(10)	110	(353)	(4,088)	(500)	5,808
Equity in earnings (losses) of affiliates			27	(274)	450
Net loss	$ (17,624)	$ (13,639)	$ (14,586)	$ (7,287)	$ (3,302)
Loss per share diluted	$ (0.57)	$ (0.45)	$ (0.48)	$ (0.24)	$ (0.11)
Weighted average common shares used in per share calculations diluted	31,129	30,648	30,413	30,042	29,928
Consolidated Balance Sheets Data:					
Total assets	$ 63,685	$ 87,653	$ 101,404	$ 127,544	$ 123,461
Total long-term debt			616		
Stockholders equity	50,657	67,658	80,766	93,972	99,136
Dividends					

(1) We had sales of POLARIS system product inventory that had previously been written down to zero with an original cost of $0.6 million during fiscal 2009, $0.9 million during fiscal 2008 and 2007, $2.1 million during fiscal 2006 and $0.05 million during fiscal 2005.

(2) During fiscal 2005, we recorded a $7.0 million gain on the sale of the Allen, Texas facility.

(3) During fiscal 2005, we recorded a gain of $5.8 million on the Nortem (formerly Metron Technology) distributions.

(4) During fiscal 2006, we recorded an impairment charge of $0.5 million related to an investment in a Malaysian foundry.

(5) We recorded stock-based compensation expense of $52,000 in cost of goods sold, $301,000 in selling, general and administrative expenses and $129,000 in research and development expenses in fiscal 2009, $43,000 in cost of goods sold, $401,000 in selling, general and administrative expenses and $121,000 in research and development expenses in fiscal 2008, $28,000 in cost of goods sold, $439,000 in selling, general and administrative expenses and $126,000 in research and development expenses during fiscal 2007 and $54,000 in cost of goods sold, $743,000 in selling, general and administrative expenses and $342,000 in research and development expenses during fiscal 2006.

(6) During fiscal 2007, we recorded an impairment and loss on sale of investment of $4.1 million related to transactions with Apprecia. See Note 3 of the Notes to Consolidated Financial Statements for a discussion of our ownership of Apprecia.

(7) During fiscal 2007, we recorded severance and outplacement costs of $296,000 to cost of goods sold, $923,000 to selling, general and administrative expense and $592,000 to research and development expense. See Note 17 of the Notes to Consolidated Financial Statements for a discussion of these costs.

(8) During fiscal 2008, we recorded severance and outplacement costs of $142,000 to cost of goods sold, $1,314,000 to selling, general and administrative expense and $536,000 to research and development expense. See Note 17 of the Notes to Consolidated Financial Statements for a discussion of these costs.

(9) During fiscal 2009, we recorded severance and outplacement costs of $604,000 to cost of goods sold, $1,133,000 to selling, general and administrative expense and $875,000 to research and development expense. See Note 17 of the Notes to Consolidated Financial Statements for a discussion of these costs.

(10) During fiscal 2008, we recorded an other than temporary impairment of $353,000 related to our investment in auction rate securities. During fiscal 2009, $110,000 of this other than temporary impairment was recovered through the sale of certain auction rate securities. See Note 18 of the Notes to Consolidated Financial Statements for a discussion of this impairment.

ITEM 7. *MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS*

Application of Critical Accounting Policies and Estimates

In accordance with Securities and Exchange Commission guidance, those material accounting policies that we believe are the most critical to an investor s understanding of our financial results and condition and require complex management judgment are discussed below.

Our critical accounting policies and estimates are as follows:

- revenue recognition;
- valuation of long-lived assets;
- estimation of valuation allowances and accrued liabilities, specifically product warranty, inventory provisions and allowance for doubtful accounts;
- stock-based compensation; and
- income taxes.

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Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the purchase price is fixed or determinable and collectibility is reasonably assured. If our equipment sales involve sales to our existing customers who have previously accepted the same type(s) of equipment with the same type(s) of specifications, we account for the product sales as a multiple element arrangement. Revenue from multiple element arrangements is allocated among the separate accounting units based on the residual method. Under the residual method, the revenue is allocated to undelivered elements based on fair value of such undelivered elements and the residual amounts of revenue allocated to delivered elements. We recognize the equipment revenue upon shipment and transfer of title. The other multiple elements also include installation, service contracts and training. Equipment installation revenue is valued based on estimated service person hours to complete installation and quoted service labor rates and is recognized when the installation has been completed and the equipment has been accepted by the customer. Service contract revenue is valued based on estimated service person hours to complete the service and published or quoted service labor rates and is recognized over the contract period. Training revenue is valued based on quoted training class prices and is recognized when the customers complete the training classes or when a customer-specific training period has expired. The quoted service labor rates and training class prices are rates actually charged and billed to our customers.

All other product sales with customer-specific acceptance provisions are recognized upon customer acceptance. Future revenues may be negatively impacted if we are unable to meet customer-specific acceptance criteria. Revenue related to spare part sales is recognized upon shipment or delivery based on the title transfer terms. Revenues related to maintenance and service contracts are recognized ratably over the duration of such contracts.

The timing and amount of revenue recognized depends on whether revenue is recognized upon shipment versus acceptance. For revenue recognized upon acceptance, it is dependent upon when customer-specific criteria are met.

Valuation of Long-Lived Assets

We assess the impairment of long-lived assets whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, in accordance with Financial Accounting Standards Board (FASB) SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. An asset or asset group is considered impaired if its carrying amount exceeds the undiscounted future net cash flow the asset or asset group is expected to generate. If an asset or asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. If estimated fair value is less than the book value, the asset is written down to the estimated fair value and an impairment loss is recognized.

If we determine that the carrying amount of long-lived assets may not be recoverable, we measure any impairment based on the fair value of the long-lived assets. Net long-lived assets amounted to $15.1 million as of August 29, 2009.

In fiscal 2009, we did not generate positive cash flows from operations. If our long-term future plans do not yield positive cash flows in excess of the carrying amount of our long-lived assets, we would anticipate possible future impairments of those assets.*

Considerable management judgment is necessary in estimating future cash flows and other factors affecting the valuation of long-lived assets, including intangible assets, including the operating and macroeconomic factors that may affect them. We use historical financial information, internal plans and projections and industry information in making such estimates.

Product Warranty

We record a liability for warranty claims at the time of sale. The amount of the liability is based on the trend in the historical ratio of claims to sales, releases of new products and other factors. The warranty periods

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for new equipment manufactured by us range from six months to two years. Special warranty provisions are also accrued for major rework campaigns. Although management believes the likelihood to be relatively low, claims experience could be materially different from actual results because of the introduction of new, more complex products; competition or other external forces; manufacturing changes that could impact product quality; or as of yet unrecognized defects in products sold.

Warranty provisions and claims for the fiscal years ended August 29, 2009, August 30, 2008, and August 27, 2007 were as follows (in thousands):

	August 29, 2009	August 30, 2008	August 25, 2007
Beginning balance	$ 2,757	$ 3,811	$ 3,964
Warranty provisions	405	1,153	1,514
Warranty claims	(1,460)	(2,207)	(1,667)
Ending balance	$ 1,702	$ 2,757	$ 3,811

Inventory Provisions

We record provisions for inventory shrinkage and for potentially excess, obsolete and slow moving inventory. The amounts of these provisions are based upon historical loss trends, inventory levels, physical inventory and cycle count adjustments, expected product lives, forecasted sales demand and recoverability. Results could be materially different if demand for our products decreased because of economic or competitive conditions, length of the industry downturn, or if products become obsolete because of technical advancements in the industry or by us.

Since we recorded the POLARIS system product inventory provisions as a result of the wind-down of our Microlithography business in the second quarter of fiscal 2003, we have had sales of POLARIS system product inventory that had previously been written down to zero and reductions in inventory buyback requirements of $11.3 million and have disposed of $13.3 million of POLARIS system product inventory. The original cost of POLARIS system product inventory available for sale or to be disposed of as of August 29, 2009 that has been written down to zero was approximately $1.8 million.

Allowance for Doubtful Accounts

Management must make estimates of the uncollectibility of our accounts receivable. The most significant risk is the risk of sudden unexpected deterioration in the financial condition of a significant customer who is not considered in the allowance. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Results could be materially impacted if the financial condition of a significant customer deteriorated and related accounts receivable are deemed uncollectible. Accounts receivable are determined to be past due based on payment terms and are charged off after management determines that they are uncollectible. As of the end of fiscal 2009, our accounts receivable included $2.0 million attributable to a past due receivable with a customer in Asia. The customer has delayed payment due to their cash flow issues and lower than expected capacity utilization. Management is working on obtaining a letter of credit for the outstanding amount with expected redemption in January 2010.* Management still believes that this receivable is collectible and will continue to monitor the situation closely.*

A rollforward of the allowance for doubtful accounts for the fiscal years ended August 29, 2009, August 30, 2008 and August 25, 2007 is as follows (in thousands):

	Balance at Beginning of Year	Recoveries	Bad Debt Expense	Adjustments	Write-offs	Balance at End of Year
Fiscal year ended August 29, 2009	$ 128	$ (21)	$ 18	$	$	$ 125
Fiscal year ended August 30, 2008	$ 196	$ (68)		$	$	$ 128
Fiscal year ended August 25, 2007	$ 520	$ (55)		$ (43)	$ (226)	$ 196

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We collected $21,000 of receivables in fiscal 2009, $68,000 of receivables in fiscal 2008 and $55,000 in fiscal 2007 that had previously been written off resulting in credits to selling, general and administrative expenses.

Stock-Based Compensation

We implemented the fair value recognition provisions of SFAS No. 123R effective August 28, 2005 using the modified prospective method. Under this method, we recognize compensation expense for all stock-based awards granted on or after August 28, 2005 and for previously granted awards not yet vested as of August 28, 2005. We recorded stock compensation expense of $482,000 in fiscal 2009, $565,000 in fiscal 2008 and $593,000 in fiscal 2007.

We utilize a Black-Scholes option-pricing model to estimate fair value of each award on the date of grant. The Black-Scholes model requires the input of certain assumptions that involve management judgment. Key assumptions that affect the calculation of fair value include the expected life of stock-based awards and our stock price volatility. Additionally, we expense for only those shares expected to vest. The assumptions used in calculating the fair value of stock-based awards and the forfeiture rate of such awards reflect management s best estimates. However, circumstances may change and additional data may become available over time, which could result in changes to these assumptions that materially impact the fair value determination of future awards or their estimated rate of forfeiture. If factors change and we use different assumptions in the application of SFAS 123R in future periods, the compensation expense recorded under SFAS 123R may differ significantly from the expense recorded in the current period. See Note 12 of Notes to Consolidated Financial Statements for additional information on stock-based compensation.

Income Taxes

Our effective income tax rate is based on income, statutory tax rates and tax planning opportunities available to us in the various jurisdictions in which we operate. We have established valuation allowances against a portion of the U.S. and non-U.S. net operating losses to reflect the uncertainty of our ability to fully utilize these benefits given the limited carryforward periods permitted by the various jurisdictions. The evaluation of the realizability of our net operating losses requires the use of considerable management judgment to estimate the future taxable income for the various jurisdictions, for which the ultimate amounts and timing of such estimates may differ. The valuation allowance can also be impacted by changes in the tax regulations.

Significant judgment is required in determining our unrecognized tax benefits. We have established accruals using management s best judgment and adjust these accruals as warranted by changing facts and circumstances. A change in our tax liabilities in any given period could have a significant impact on our results of operations and cash flows for that period.

We adopted the provisions of FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an Interpretation of FASB Statement No. 109, during the first quarter of fiscal 2008. During fiscal 2009, the accrual for unrecognized tax benefits decreased by $0.1 million as a result of a lapse of the applicable statue of limitations. During fiscal 2008, we effectively settled tax audits in foreign tax jurisdictions which resulted in a $0.6 million decrease in the accrual for unrecognized tax benefits. The benefit was partially offset by state income tax expense and foreign tax expense.

Industry Update

It appears that the global economic conditions that led to one of the worst declines in the history of the microelectronic industry may be slowly subsiding. However, even with the modest improvement in semiconductor and semiconductor equipment industry fundamentals that began in the summer of 2009, Gartner, Inc., a leading equipment industry research group, recently forecasted that calendar 2009 worldwide semiconductor revenue will decrease 17.0 percent and equipment spending will decrease 47.9 percent from the calendar 2008 levels.

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Many semiconductor manufacturers are increasing their production capacity as they experience improved factory utilization rates, particularly foundries that provide outsourcing services for logic device producers and microprocessor suppliers. It appears that leading memory device manufacturers are continuing to spend on equipment that enables technology advancement and increased productivity. In general, equipment providers are optimistic that as economic and industry conditions continue to improve, capacity spending by memory manufacturers, driven by higher utilization rates and better device pricing, quarterly spending will begin to increase in 2010.*

As a result of the improving industry conditions, Gartner recently forecasted that semiconductor revenues will grow 10.3 percent, to $233 billion, in calendar 2010, from the expected $212 billion level in calendar 2009. Along with higher chip unit prices, demand for smart phones, personal computers and other consumer electronics are expected to fuel the year-over-year growth. Gartner recently forecasted that equipment revenues will increase 39.1 percent in calendar 2010, to $22.2 billion, from the expected $16.0 billion level in calendar 2009. In addition to continued logic capacity spending, memory capacity additions are expected to contribute to the year-over-year revenue increase.

Overview

Industry conditions began to improve during the fourth quarter of fiscal 2009 as end-use electronic product demand started to improve and semiconductor manufacturers continued to receive restocking orders. Some of the product demand improvement was driven by economic stimulus programs. With many of our customers experiencing higher utilization of their factories, they increased spending for spare parts and services during the fourth quarter as compared to the third quarter of fiscal 2009.

The fiscal 2009 protracted industry downturn led to our implementation of cost reductions in September 2008 and March 2009, including a reduction in our headcount by approximately 150 positions, representing 38 percent of our workforce as of the end of fiscal 2008. In conjunction with the staff reductions, we consolidated our European and U.S. sales and service organizations to better serve our customers. In addition, we transferred some of the activities from our Allen, Texas facility to our Chaska, Minnesota facility and significantly reduced the amount of space being leased in Allen. The salary reductions implemented in January 2009 remain in effect.

Despite the impact that weak economic conditions had upon the industry and the Company during fiscal 2009, we accomplished several key milestones, including:

Market share gains Worldwide revenues for surface conditioning clean and dry equipment as reported by Semiconductor Equipment and Materials Industry, a leading industry organization, declined approximately 50 percent from fiscal 2008 to fiscal 2009 while the Company s revenue declined only approximately 36 percent over the same period, reflecting a modest market share gain for the Company.

Improved earnings leverage From fiscal 2008 to fiscal 2009, through restructuring and other cost reduction initiatives, the Company reduced its total operating expenses by 28.8 percent, thereby lowering its breakeven levels.

ORION® acceptance The Company gained acceptance for its ORION single wafer cleaning system, for both 45 and 32nm BEOL applications, at a major U.S. semiconductor manufacturer and shipped an evaluation FSI ORION system to a major Korean producer for FEOL applications development, including the Company s patented ViPR™ technology. Recently, the Company received a follow-on order for an ORION system that will be used for 32nm production and 22nm development.

ZETA® market expansion The Company successfully placed its ZETA ViPR batch spray cleaning system at several new customers and expanded the number of applications and manufacturing lines within customers that are utilizing the ZETA ViPR[tm] technology.

Going forward, the Company remains focused on aligning its cost structure to support the anticipated revenue run rate increase while funding the programs that provide the most significant opportunity for near-term revenue and future market share gains.* For a discussion of our limited capital resources, see Liquidity and Capital Resources below.

Results of Operations

Sales Revenue and Shipments

Fiscal 2009 sales revenue decreased to $50.5 million as compared to $78.3 million in fiscal 2008. The decrease in sales revenue in fiscal 2009 related to the decline in shipments from $77.9 million in fiscal 2008 to $47.8 million in fiscal 2009 associated with industry and global economic conditions. Fiscal 2008 sales revenue decreased to $78.3 million as compared to $116.2 million in fiscal 2007. The decrease in sales in fiscal 2008 related to the decline in shipments from $116.9 million in fiscal 2007 to $77.9 million in fiscal 2008 associated with industry conditions.

Based upon our revenue recognition policy, certain shipments to customers are not recognized until customer acceptance. Therefore, depending on timing of shipments and customer acceptances, there are time periods where shipments may exceed sales revenue or due to timing of acceptances, sales revenue may exceed shipments.

International sales were $35.8 million for fiscal 2009, representing 71% of total sales during fiscal 2009, $59.3 million for fiscal 2008, representing 76% of total sales during fiscal 2008, and $79.6 million for fiscal 2007, representing 69% of total sales during fiscal 2007. The decrease in fiscal 2009 international sales dollar amount as compared to fiscal 2008 was related to decreases in sales in Europe, Southeast Asia and Japan of $25.9 million, partially offset by an increase of $2.4 million in Korea. The decrease in fiscal 2008 international sales dollar amount as compared to fiscal 2007 was related to decreases in Europe, Southeast Asia and Japan of $21.6 million, partially offset by an increase of $1.6 million in Korea. See Note 14 of the Notes to Consolidated Financial Statements for additional information regarding our international sales.

We ended fiscal 2009 with a backlog of approximately $7.9 million as compared to $5.6 million at the end of fiscal 2008. Backlog consists of orders with delivery dates within the next 12 months for which a customer purchase order has been received. Because of the timing and relative size of orders and the possibility of cancellations or customer delays, backlog is not necessarily indicative of sales for future periods.

We expect first quarter fiscal 2010 orders to be between $15 million and $18 million.* This assumes the receipt of several follow-on orders that are anticipated late in the quarter.* We expect first quarter fiscal 2010 revenue to be in the range of $13 million to $16 million, which assumes continued increases in spares and service revenue along with receipt of the anticipated follow-on orders in the first quarter of fiscal 2010.*

Gross Margin

Our gross profit margin fluctuates due to a number of factors, including the mix of products sold; the geographic mix of products sold, with international sales generally having lower gross profit than domestic sales; initial product placement discounts; utilization of manufacturing capacity; sales of POLARIS system product inventory previously written down to zero; and the competitive pricing environment.

Gross margin as a percentage of sales was 32.5% for fiscal 2009 as compared to 42.1% for fiscal 2008 and 40.5% for fiscal 2007. The decrease in gross margin from fiscal 2008 to fiscal 2009 related primarily to a decrease in utilization of manufacturing capacity in fiscal 2009 as compared to fiscal 2008 related to the decline in shipments from $77.9 million in fiscal 2008 to $47.8 million in fiscal 2009. The increase in gross margin from fiscal 2007 to fiscal 2008 related primarily to a change in product mix in which the sale of spare parts and service represented 34% of our total sales in fiscal 2008 as compared to 26% in fiscal 2007, as spare parts and service generally have higher margins.

This positive impact was partially offset by a decrease in utilization of manufacturing capacity in fiscal 2008 as compared to fiscal 2007 related to the decline in shipments from $116.9 million in fiscal 2007 to $77.9 million in fiscal 2008. Severance costs included in cost of sales were $604,000 in fiscal 2009, $142,000 in fiscal 2008 and $296,000 in fiscal 2007. We had sales of POLARIS system inventory previously written down to zero of $0.6 million in fiscal 2009 and $0.9 million in both fiscal 2008 and 2007.

We will continue to try to sell the POLARIS system product inventory that had previously been written down to zero to our customers as spares, refurbished systems and upgrades to existing systems. If unsuccessful, some of the items will be disposed. Any material sales of the impaired inventory will be disclosed. The original cost of POLARIS system product inventory available for sale or to be disposed of as of August 29, 2009 that has been written down to zero was approximately $1.8 million.

Due to an expected change in our product mix, partially offset by improved factory utilization, we expect the gross profit margins for the first quarter of fiscal 2010 to be approximately 38% to 40% of revenues.*

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $19.5 million, or 38.6% of total sales, in fiscal 2009, as compared to $29.0 million, or 37.1% of total sales, in fiscal 2008 and $34.5 million, or 29.7% of total sales, in fiscal 2007. The decrease in selling, general and administrative dollar amount in fiscal 2009 as compared to fiscal 2008 related primarily to the cost reduction initiatives associated with reductions in headcount and salary reductions taken in fiscal 2009 and improved service technician utilization rates. Severance costs included in fiscal 2009 selling, general and administrative expense were $1.1 million. The decrease in selling, general and administrative dollar amount in fiscal 2008 as compared to fiscal 2007 related to the decrease in sales and the cost reduction initiatives associated with reductions in headcount taken in the second half of fiscal 2007, partially offset by realignment expenses of $1.3 million in fiscal 2008 compared to severance costs of $0.9 million in fiscal 2007.

Selling, general and administrative expenses for the first quarter of fiscal 2010 are expected to be in the range of $3.6 million to $3.8 million, as we experience the full benefit of prior year cost reductions.*

Research and Development Expenses

Research and development expenses for fiscal 2009 were $14.7 million, or 29.1% of total sales, as compared to $19.0 million, or 24.2% of total sales, in fiscal 2008, and $24.1 million, or 20.7% of total sales, in fiscal 2007. The decrease in dollar amount in fiscal 2009 as compared to fiscal 2008 related primarily to the cost reduction initiatives associated with reductions in headcount and salary reductions taken in fiscal 2009, partially offset by $0.9 million of severance costs in fiscal 2009 as compared to $0.5 million in fiscal 2008. The decrease in dollar amounts in fiscal 2008 as compared to fiscal 2007 related primarily to cost reduction efforts associated with headcount reductions taken in the second half of fiscal 2007.

A significant portion of our fiscal 2009 research and development resources were focused on broadening the applications capabilities of our products and supporting demonstrations and customer evaluations of our products.

We expect research and development expenses to range from $2.6 million to $2.8 million for the first quarter of fiscal 2010, as we continue to invest in our ORION® single wafer and ZETA® ViPR™ programs and product cost reduction initiatives.*

Gain on Sale of Marketable Securities/(Impairment of Investments)

We recorded a gain on sale of marketable securities of $110,000 associated with ARS redemptions in fiscal 2009. We recorded an other than temporary impairment of $353,000 in fiscal 2008 associated with our ARS. See further discussion related to ARS transactions at Note 18 of Notes to Consolidated Financial Statements. We recorded $4.1 million of impairment and loss on the sale of investment in fiscal 2007 related to transactions with Apprecia. See further discussion related to the transactions and the impairment at Note 3 of the Notes to Consolidated Financial Statements.

Income Tax Expense

We recorded an income tax benefit of $84,000 in fiscal 2009 related primarily to R&D credit utilization in lieu of bonus depreciation and the expiration of uncertain tax positions as a result of a lapse of the applicable statue of limitations. We recorded income tax benefit of $624,000 in fiscal 2008 related to uncertain tax positions that were effectively settled with tax authorities during fiscal 2008, partially offset by state income tax expense and foreign tax expense. We recorded income tax expense of $122,000 in fiscal 2007, primarily as a result of foreign and state taxes. As of August 29, 2009 and August 30, 2008, we had $0.5 million and $0.6 million, respectively, of liabilities recorded related to unrecognized tax benefits. Accrued interest and penalties on these unrecognized tax benefits were $0.1 million as of August 29, 2009 and August 30, 2008. We recognize potential interest and penalties related to income tax positions, if any, as a component of provision for income taxes on the consolidated statements of operations. Included in the liability balance as of August 29, 2009 are approximately $0.4 million of unrecognized tax benefits that, if recognized, will affect our effective tax rate.

Our deferred tax assets on the balance sheet as of August 29, 2009 have been fully reserved for with a valuation allowance. We do not expect to reduce our valuation allowance until we are consistently profitable on a quarterly basis.*

We have net operating loss carryforwards for federal income tax purposes of approximately $188.0 million at August 29, 2009, which will begin to expire in fiscal 2011 through fiscal 2030 if not utilized. Of this amount, approximately $15.0 million is subject to Internal Revenue Code Section 382 limitations on utilization, which limits the amount that we can offset taxable income to approximately $1.4 million per year.

Net Loss

Net loss was $17.6 million in fiscal 2009 as compared to $13.6 million in fiscal 2008 and $14.6 million in fiscal 2007. The increase in net loss in fiscal 2009 as compared to fiscal 2008 is primarily due to lower sales and gross margin in fiscal 2009 and higher severance costs in fiscal 2009, partially offset by lower operating expenses. The decrease in net loss in fiscal 2008 as compared to fiscal 2007 is primarily due to the impairment and loss on sale of investment of $4.1 million related to transactions with Apprecia in fiscal 2007 offset by lower sales in fiscal 2008. The decrease in net loss in fiscal 2008 as compared to fiscal 2007 also related to a net income tax benefit of $624,000 in fiscal 2008 as compared to income tax expense of $122,000 in fiscal 2007.

Based upon achieving anticipated revenue, gross margin and operating expense levels, we expect to record a net loss of less than $1.0 million in the first quarter of fiscal 2010.*

Liquidity and Capital Resources

Our cash, restricted cash, cash equivalents and marketable securities were approximately $12.0 million as of August 29, 2009, a decrease of $10.8 million from the end of fiscal 2008. The net decrease was primarily due to $10.1 million used in operations, $0.3 million in capital expenditures and $0.8 million of principal payments on capital leases. The decreases were net of $0.2 million of proceeds from the issuance of common stock.

As of August 29, 2009, we had investments in ARS reported at a fair value of $4.5 million after reflecting a $0.2 million other than temporary impairment against $4.7 million par value. The other than temporary impairment was recorded in fiscal 2008. We value the majority of our ARS using a mark-to-model approach that relies on discounted cash flows, market data and inputs derived from similar instruments. This model takes into account, among other variables, the base interest rate, credit spreads, downgrade risks and default/recovery risk, the estimated time required to work out the disruption in the traditional auction process and its effect on liquidity, and the effects of insurance and other credit enhancements. However, we value certain ARS based on the price at which the issuer offered to repurchase such ARS in a conditional tender offer we received in October 2008 from the issuer.

The ARS we hold are marketable securities with long-term stated maturities for which the interest rates are reset every 28 days through an auction process. The auctions have historically provided a liquid market for these securities as investors historically could readily sell their investments at auction. Due to the liquidity issues experienced in global credit and capital markets, the ARS held by us have experienced multiple failed auctions, beginning on February 19, 2008, as the amount of securities submitted for sale has exceeded the

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amount of purchase orders. During the second quarter of fiscal 2008, we reclassified $8.5 million of ARS from current marketable securities to long-term marketable securities on the condensed consolidated balance sheet due to difficulties encountered at auction and the conditions in the general debt markets, creating uncertainty as to when successful auctions may be reestablished. During the third and fourth quarters of fiscal 2008, $0.8 million of ARS were partially redeemed. An additional $3.0 million were redeemed in fiscal 2009.

All of the ARS held by us continue to carry investment grade ratings and have not experienced any payment defaults. The $4.7 million par value ARS held by us are backed by student loans and are collateralized, insured and guaranteed by the United States Federal Department of Education and are classified as long-term. ARS that did not successfully auction reset to the maximum interest rate as prescribed in the underlying indenture and all of our holdings continue to be current with their interest payments. If uncertainties in the credit and capital markets continue, these markets deteriorate further or any ARS we hold are downgraded by the rating agencies, the Company may be required to recognize additional impairment charges.

In addition, these ARS may not provide the liquidity to us as we need it, and it could take until the final maturity of the underlying notes (from 26 to 34 years) to realize our investments recorded value. Currently, there is a very limited market for any of these securities and future liquidations at this time, if possible, would likely be at a significant discount.

Accounts receivable decreased $0.9 million from the end of fiscal 2008. The decrease in trade accounts receivable related primarily to the decrease in shipments from $13.0 million in the fourth quarter of fiscal 2008 to $12.5 million in the fourth quarter of fiscal 2009. The balance at the end of fiscal 2009 included $2.0 million attributed to a past due receivable with a customer in Asia. The customer has delayed payment due to their cash flow issues and lower than expected capacity utilization. We are working on obtaining a letter of credit for the balance with expected payment in January 2010. Trade receivables will fluctuate quarter to quarter depending on individual customers timing of ship dates, payment terms and cash flow conditions. In certain situations, extended payment terms may be granted to customers.

Inventory decreased approximately $6.0 million to $21.2 million at the end of fiscal 2009, as compared to $27.2 million at the end of fiscal 2008. The decrease in inventory related to decreases in work in process and raw materials inventory attributable primarily to inventory initiatives implemented during fiscal 2009. Inventory provisions were $9.2 million at August 29, 2009, as compared to provisions of $15.9 million at the end of fiscal 2008. The decrease in inventory provisions related primarily to the disposal of $8.2 million of excess and obsolete inventory during fiscal 2009.

Trade accounts payable decreased approximately $1.1 million to $3.2 million as of August 29, 2009, as compared to $4.3 million at the end of fiscal 2008, related to the timing of inventory receipts and vendor payments.

Deferred profit was $2.4 million at the end of fiscal 2009 and $3.9 million at the end of fiscal 2008. The decrease in deferred profit related primarily to the timing of tool acceptances.

As of August 29, 2009, our current ratio was 3.3 to 1.0, and working capital was $29.3 million.

The following table provides aggregate information about our contractual payment obligations and the periods in which payments are due (in thousands):

	Payments Due by Period		
	Less than	**1-3**	**3-5**

Contractual Obligations	Total	1 Year	Years	Years	More than 5 Years
Operating Lease Obligations	$ 1,055	$ 591	$ 428	$ 25	$ 11
Purchase Obligations	3,653	3,653			
Royalty Obligations	226	226			
Other Long-Term Obligations(1)	1,368	118	500	500	250
Total	$ 6,302	$ 4,588	$ 928	$ 525	$ 261

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(1) Other long-term obligations represent payments related to minimum royalty payments or discounts granted under a license agreement.

The contractual obligations table above does not include $0.5 million accruals for unrecognized tax benefits, as the timing of payments or reversals is uncertain.

Capital expenditures were $0.3 million in fiscal 2009, $1.7 million in fiscal 2008, and $1.6 million in fiscal 2007. We expect capital expenditures to be less than $400,000 in the first quarter of fiscal 2010, primarily associated with the buyout of a lease for laboratory equipment.* Depreciation is expected to be between approximately $0.6 million and $0.7 million in the first quarter of fiscal 2010.*

In October 2008, we authorized the use of up to $3 million of our cash to repurchase outstanding shares of our common stock to be effected from time to time in transactions in the public markets or in private purchases. The timing and extent of any repurchases will depend upon market conditions, the trading price of our shares and other factors, subject to the restrictions relating to volume, price and timing of share repurchases under applicable law. The repurchase program may be modified, suspended or terminated at any time by us without notice. We did not repurchase any of our common stock in fiscal 2009.

In light of our financial condition, we implemented a number of cost reduction steps in fiscal 2009 to reduce our use of cash, as discussed in Note 17 of the Notes to Condensed Consolidated Financial Statements. Our cost reduction actions in fiscal 2009 are expected to lower our annual operating expenses by $11 to $12 million, which is expected to reduce our cash flow breakeven revenue level to approximately $12 to $14 million per quarter, depending on the gross margins and the timing of shipments and accounts receivable collections.* In addition, we plan to manage cash flows by reducing capital expenditures to less than $500,000 in fiscal 2010 and to aggressively improve our working capital levels in the second half of fiscal 2010.* Management believes that these actions will allow us to have sufficient cash to fund our operations through at least fiscal 2010.*

We do not have any revolving line of credit or other form of debt financing. If the economic environment does not improve in early fiscal 2010 and, notwithstanding our cash management initiatives, more cash is needed to fund operations than expected, we may need to take additional actions.* These actions could include additional cost reduction measures and possible cash generating activities, including exploring a sale-leaseback arrangement for our Chaska, Minnesota facility, entering into an asset-based lending arrangement, borrowing up to $3.2 million against or liquidating our remaining life insurance investments of $3.5 million, borrowing up to 50% against or selling some or all of our currently illiquid ARS, possibly at a loss, or selling additional equity.* We can provide no assurance that any of these cash-generating activities will be available to us when needed, or if available, on such terms that will be acceptable or in sufficient amounts to cover our operating expenses at such time. The sale of additional equity would likely result in additional dilution to our shareholders.* In addition, without substantial available capital, we may be unable to take advantage of strategic opportunities as they arise, such as investments in or acquisitions of businesses, products or technologies.*

At the expected revenue and expense run rate, we anticipate using less than $2.0 million of cash for operations in the first quarter of fiscal 2010.* We believe that with existing cash, cash receipts, cash equivalents, marketable securities and internally generated funds, there will be sufficient funds to meet our currently projected working capital requirements, and to meet other cash requirements through at least fiscal 2010.* We believe that success in our industry requires substantial capital to maintain the flexibility to take advantage of opportunities as they arise. One of our strategic objectives is, as market and business conditions warrant, to consider divestitures, investments or acquisitions of businesses, products or technologies. We may fund such activities with additional equity or debt financing.* The sale of additional equity or debt securities, whether to maintain flexibility or to meet strategic objectives, could result in additional dilution to our shareholders.*

Off-Balance Sheet Arrangements

We do not have any off balance sheet arrangements.

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New Accounting Pronouncements

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements. SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair-value measurements. This statement applies only to fair-value measurements that are already required or permitted by other accounting standards, except for measurements of share-based payments and measurements that are similar to, but not intended to be, fair value. This statement is expected to increase the consistency of fair value measurements, but imposes no requirements for additional fair-value measures in financial statements. The provisions under SFAS No. 157 were effective for us beginning in the first quarter of fiscal 2009. The adoption of this pronouncement did not have an impact on our consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 amends SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and permits entities to choose to measure many financial instruments and certain other items at fair value. SFAS No. 159 was effective for us beginning in the first quarter of fiscal 2009. We do not measure any of our financial instruments at fair value as permitted under SFAS 159.

In December 2007, the FASB issued SFAS 141 (revised 2007) (SFAS 141R), Business Combinations, and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, to improve, simplify, and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements, respectively. The provisions of SFAS 141R and SFAS 160 are effective for us beginning in the first quarter of fiscal 2010. We do not expect the adoption of these pronouncements to have an impact on our consolidated financial statements.

In April 2009, the FASB issued FASB Staff Position (FSP), FAS 115-2 and FAS 124-2, Recognition and Presentation of Other-Than-Temporary Impairments (FSP FAS 115-2 and FAS 124-2), which amends current other-than-temporary impairment guidance in generally accepted accounting principles in the United States for debt securities to make the guidance more operational and to improve the presentation and disclosure of other-than-temporary impairments on debt and equity securities in the financial statements. This FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. The provisions of FSP FAS 115-2 and FAS 124-2 are effective for our fiscal year ending August 29, 2009. The implementation of FSP FAS 115-2 and FAS 124-2 did not have an impact on our financial position and results of operations.

In May 2009, the FASB issued SFAS No. 165, Subsequent Events. SFAS No. 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This SFAS requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The disclosure requirement under this SFAS is effective for our annual reporting for our fiscal year ending August 29, 2009. We evaluated subsequent events through the date and time the financial statements were issued on November 12, 2009.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles-a replacement of FASB Statement No. 162. SFAS No. 168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This SFAS is effective for our fiscal 2010 first quarter. This SFAS is not expected to have a material impact on our consolidated financial statements.

On September 23, 2009, the FASB reached a consensus on two new pronouncements, Emerging Issues Task Force (EITF) No. 08-1, Revenue Arrangements with Multiple Deliverables (previously titled, Revenue Recognition for a Single Unit of Accounting) and EITF No. 09-3, Applicability of Statement of Position 97-2 to Certain Arrangements That Include Software Elements. These new pronouncements are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after

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June 15, 2010. Early adoption is permitted and we are evaluating the timing of adoption and the impact that adoption of these EITFs will have on our consolidated financial statements.

ITEM 7A. *QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK*

Our cash flows and earnings are subject to fluctuations in foreign exchange rates due to certain foreign investments. As of August 29, 2009, our investments included a 100% interest in our Europe and Asia sales and service offices and a 20% interest in Apprecia Technology, Inc. (formerly known as m FSI LTD), which operates in Japan. We denominate the majority of our sales outside of the U.S. in U.S. dollars.

We have direct sales, service and applications support and logistics responsibilities for our products in Europe and the Asia-Pacific regions and incur labor, service and other expenses in foreign currencies. As a result, we may be exposed to fluctuations in foreign exchange rate risks.* As of August 29, 2009, we had not entered into any hedging activities and our foreign currency transaction gains and losses for fiscal 2009 were insignificant. We are currently evaluating various hedging activities and other options to minimize these risks.

We do not have significant exposure to changing interest rates as we currently have no material long-term debt. As of the end of fiscal 2009, amortized cost approximated market value for all outstanding marketable securities. We do not undertake any specific actions to cover our exposure to interest rate risk and we are not party to any interest rate risk management transactions. The impact on loss before income taxes of a 1% change in short-term interest rates would be approximately $120,000 based on our cash, restricted cash, cash equivalents and marketable securities balances as of August 29, 2009.

As of August 29, 2009, our investment portfolio included ARS reported at a fair value of $4.5 million after reflecting a $0.2 million other than temporary impairment against $4.7 million par value. The other than temporary impairment was recorded in fiscal 2008. The interest rates of our ARS are reset every 28 days through an auction process and at the end of each reset period, investors can sell or continue to hold the securities at par.

The ARS held by us are backed by student loans and are collateralized, insured and guaranteed by the United States Federal Department of Education. All ARS held by us are rated by the major independent rating agencies and carry investment grade ratings and have not experienced any payment defaults.

All of our ARS have experienced failed auctions due to sell orders exceeding buy orders. These failures are not believed to be a credit issue, but rather reflect a lack of liquidity in the market for these securities. Under the contractual terms, the issuer is obligated to pay penalty interest rates should an auction fail. In the event we need to access funds associated with failed auctions, they are not expected to be accessible until a successful auction occurs, the issuer redeems the issue, a buyer is found outside of the auction process or the underlying securities have matured and are paid upon maturity in accordance with their terms.

We determined and recorded an other than temporary impairment of approximately $0.4 million as of August 28, 2008. Approximately $0.1 million of this other than temporary impairment was reversed in fiscal 2009 associated with the redemption of approximately $3.0 million ARS at par. If the issuers of the ARS are unable to successfully close future auctions or do not redeem the ARS, or the United States government fails to support its guaranty of the obligations, we may be required to record additional impairment charges.

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ITEM 8. *FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA*

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF OPERATIONS
Years ended August 29, 2009, August 30, 2008 and August 25, 2007

	2009	2008	2007
	(In thousands, except per share amounts)		
Sales (including sales to affiliates of $0, $0, and $5,355, respectively)	$ 50,484	$ 78,256	$ 116,233
Cost of goods sold	34,057	45,271	69,110
Gross margin	16,427	32,985	47,123
Selling, general and administrative expenses	19,504	29,012	34,542
Research and development expenses	14,674	18,962	24,086
Operating loss	(17,751)	(14,989)	(11,505)
Interest expense	(41)	(144)	(196)
Interest income	261	918	916
Gain on sale of marketable securities (impairment of investments)	110	(353)	(4,088)
Other (expense) income, net	(287)	305	382
Loss before income taxes	(17,708)	(14,263)	(14,491)
Income tax (benefit) expense	(84)	(624)	122
Loss before equity in earnings of affiliate	(17,624)	(13,639)	(14,613)
Equity in earnings of affiliate			27
Net loss	$ (17,624)	$ (13,639)	$ (14,586)
Loss per share			
Basic	$ (0.57)	$ (0.45)	$ (0.48)
Diluted	$ (0.57)	$ (0.45)	$ (0.48)
Weighted average common shares basic	31,129	30,648	30,413
Weighted average common shares diluted	31,129	30,648	30,413

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

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

	August 29, 2009	August 30, 2008
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,760	$ 14,788
Restricted cash	818	275
Marketable securities		850
Trade accounts receivable, less allowance for doubtful accounts of $125 and $128, respectively	8,697	9,614
Inventories, net	21,171	27,169
Other receivables	2,624	4,813
Prepaid expenses and other current assets	1,710	3,339
Total current assets	41,780	60,848
Property, plant and equipment, net	15,147	18,266
Restricted cash		500
Long-term marketable securities	4,458	6,447
Investment	460	460
Intangible assets, net		61
Other assets	1,840	1,071
Total assets	$ 63,685	$ 87,653
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Trade accounts payable	$ 3,170	$ 4,305
Accrued expenses	6,972	10,392
Current portion of capital lease obligations		841
Customer deposits	12	7
Deferred profit	2,362	3,867
Total current liabilities	12,516	19,412
Long-term accrued expenses	512	583
Commitments and contingencies (Notes 4 and 19)		
Stockholders equity:		
Preferred stock, no par value; 9,700 shares authorized; none issued and outstanding		
Series A Junior Participating Preferred stock, no par value; 300 shares authorized; none issued and outstanding		
Common stock, no par value; 50,000 shares authorized; issued and outstanding, 31,636 and 30,839 shares, respectively	226,562	226,352
Accumulated deficit	(177,591)	(159,967)

Accumulated other comprehensive loss		(1,027)		(997)
Other stockholders equity		2,713		2,270
Total stockholders equity		50,657		67,658
Total liabilities and stockholders equity	$	63,685	$	87,653

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

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY AND COMPREHENSIVE LOSS
Years ended August 29, 2009, August 30, 2008 and August 25, 2007

	Common Stock			Accumulated Other	Other	
	Number of Shares	Amount	Accumulated Deficit	Comprehensive (Loss) Income	Stockholders Equity	Total
			(In thousands)			
Balance August 26, 2006	30,309	$ 225,169	$ (132,052)	$ (218)	$ 1,073	$ 93,972
Cumulative effect adjustment as a result of the adoption of SAB 108			310			310
Stock issuance	236	805				805
Comprehensive loss:						
Foreign currency translation adjustment				(357)		(357)
Net loss			(14,586)			(14,586)
Total comprehensive loss						(14,943)
Stock compensation expense					622	622
Balance August 25, 2007	30,545	225,974	(146,328)	(575)	1,695	80,766
Stock issuance	294	378				378
Comprehensive loss:						
Foreign currency translation adjustment				(422)		(422)
Net loss			(13,639)			(13,639)
Total comprehensive loss						(14,061)
Stock compensation expense					575	575
Balance August 30, 2008	30,839	226,352	(159,967)	(997)	2,270	67,658
Stock issuance	797	210				210
Comprehensive loss:						
Foreign currency translation adjustment				(30)		(30)
Net loss			(17,624)			(17,624)
Total comprehensive loss						(17,654)
					443	443

Stock compensation expense										
Balance August 29, 2009	31,636	$	226,562	$	(177,591)	$	(1,027)	$	2,713	$ 50,657

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

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS
Years ended August 29, 2009, August 30, 2008 and August 25, 2007

	2009	2008	2007
		(In thousands)	
Operating Activities			
Net loss	$ (17,624)	$ (13,639)	$ (14,586)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:			
Stock compensation expense	482	565	593
Gain on sale of marketable securities/impairment of investments	(110)	353	4,088
Depreciation	3,398	3,818	3,663
Amortization	61	436	508
Equity in earnings of affiliate			(27)
Loss (gain) on sale or disposal of equipment	46	9	(17)
Changes in operating assets and liabilities:			
Restricted cash	(43)	(124)	(6)
Trade accounts receivable	916	7,995	5,564
Inventories	5,998	2,455	6,057
Prepaid expenses and other current assets	2,933	(650)	3,837
Trade accounts payable	(1,135)	846	(5,345)
Accrued expenses	(3,530)	(307)	(3,520)
Customer deposits	5	(1,299)	(4,102)
Deferred profit	(1,505)	536	(817)
Net cash (used in) provided by operating activities	(10,108)	994	(4,110)
Investing Activities			
Capital expenditures	(325)	(1,702)	(1,590)
Purchases of marketable securities		(49,650)	(85,850)
Sales of marketable securities	2,950	50,800	88,150
Proceeds from sale of investment			1,238
Dividend from affiliate			2,047
Decrease (increase) in other assets	116	128	(39)
Proceeds from sale of property, plant and equipment			17
Net cash provided by (used in) investing activities	2,741	(424)	3,973
Financing Activities			
Net proceeds from issuance of common stock	210	378	805
Increase in restricted cash			(500)
Principle payments on capital leases	(841)	(778)	(511)
Net cash used in financing activities	(631)	(400)	(206)
Effect of exchange rate on cash	(30)	(422)	(289)

Decrease in cash and cash equivalents	(8,028)	(252)	(632)
Cash and cash equivalents at beginning of year	14,788	15,040	15,672
Cash and cash equivalents at end of year	$ 6,760	$ 14,788	$ 15,040

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

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) Description of Business and Summary of Significant Accounting Policies

Description of Business

FSI International, Inc. (the Company) is a global supplier of surface conditioning equipment (process equipment used to etch and clean organic and inorganic materials from the surface of a silicon wafer) and technology and support services for microelectronics manufacturing. The Company s broad portfolio of batch and single-wafer cleaning products includes process technologies for immersion (a method used to clean silicon wafers by immersing the wafer in multiple tanks filled with process chemicals), spray (sprays chemical mixtures, water and nitrogen in a variety of sequences on to the microelectronic substrate), vapor (utilizes gas phase chemistries to selectively remove sacrificial surface films) and CryoKinetic (a momentum transfer process used to remove non-chemically bonded particles from the surface of a microelectronic device). The Company s support services programs provide product and process enhancements to extend the life of installed FSI equipment.

The Company s customers include microelectronics manufacturers located throughout North America, Europe, Japan and the Asia Pacific region.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts of FSI International, Inc. and its wholly owned subsidiaries, FSI International Asia, Ltd., FSI International Semiconductor Equipment Pte. Ltd., FSI International (France) SARL, FSI International (Germany) GmbH, FSI International (Italy) S.r.l., FSI International (Holding) B.V., FSI International (Netherlands) B.V., FSI International (UK) Limited, FSI International (Shanghai) Co., Ltd., FSI International (Korea) Co., Ltd., FSI International Israel, Ltd., SCD Mountain View, Inc., and Semiconductor Systems, Inc. All intercompany balances and transactions have been eliminated in consolidation. During fiscal 2007, the Company closed its branch office, FSI Malaysia SDN GHD.

The Company s fiscal year ends on the last Saturday in August and is comprised of 52 or 53 weeks. Fiscal 2009 consisted of a 52-week period. Fiscal 2008 consisted of a 53-week period and fiscal 2007 consisted of a 52-week period.

New Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 157, Fair Value Measurements. SFAS No. 157 establishes a single authoritative definition of fair value, sets out a framework for measuring fair value and requires additional disclosures about fair-value measurements. This statement applies only to fair-value measurements that are already required or permitted by other accounting standards, except for measurements of share-based payments and measurements that are similar to, but not intended to be, fair value. This statement is expected to increase the consistency of fair value measurements, but imposes no requirements for additional fair-value measures in financial statements. The provisions under SFAS No. 157 were effective for the Company beginning in the first quarter of fiscal 2009. The adoption of this pronouncement did not have an impact on the Company s consolidated financial statements.

In February 2007, the FASB issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities. SFAS No. 159 amends SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities, and permits entities to choose to measure many financial instruments and certain other items at fair value.
SFAS No. 159 was effective for the Company beginning in the first quarter of fiscal 2009. The Company does not measure any of its financial instruments at fair value as permitted under SFAS 159.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In December 2007, the FASB issued SFAS 141 (revised 2007) (SFAS 141R), Business Combinations, and SFAS 160, Noncontrolling Interests in Consolidated Financial Statements, to improve, simplify, and converge internationally the accounting for business combinations and the reporting of noncontrolling interests in consolidated financial statements, respectively. The provisions of SFAS 141R and SFAS 160 are effective for the Company beginning in the first quarter of fiscal 2010. The Company does not expect the adoption of these pronouncements to have an impact on its consolidated financial statements.

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In May 2009, the FASB issued SFAS No. 165, Subsequent Events. SFAS No. 165 is intended to establish general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. This SFAS requires the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date. The disclosure requirement under this SFAS is effective for the Company s annual reporting for its fiscal year ending August 29, 2009. The Company evaluated subsequent events through the date and time the financial statements were issued on November 12, 2009.

In June 2009, the FASB issued SFAS No. 168, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles-a replacement of FASB Statement No. 162. SFAS No. 168 establishes the FASB Accounting Standards Codification as the source of authoritative accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This SFAS is effective for the Company s fiscal 2010 first quarter. This SFAS is not expected to have a material impact on the Company s consolidated financial statements.

On September 23, 2009, the FASB reached a consensus on two new pronouncements, Emerging Issues Task Force (EITF) No. 08-1, Revenue Arrangements with Multiple Deliverables (previously titled, Revenue Recognition for a Single Unit of Accounting) and EITF No. 09-3, Applicability of Statement of Position 97-2 to Certain Arrangements That Include Software Elements. These new pronouncements are effective for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Early adoption is permitted and the Company is evaluating the timing of adoption and the impact that adoption of these EITFs will have on its consolidated financial statements.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the purchase price is fixed or determinable and collectibility is reasonably assured. If the

Company s equipment sales involve sales to its existing customers who have previously accepted the same type(s) of equipment with the same type(s) of specifications, the Company accounts for the product sale as a multiple element arrangement. Revenue from multiple element arrangements is allocated among the separate accounting units based on the residual method. Under the residual method, the revenue is allocated to undelivered elements based on fair value of such undelivered elements and the residual amounts of revenue allocated to delivered elements. The Company recognizes the equipment revenue upon shipment and transfer of title. The other elements may include installation, service contracts and training.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Equipment installation revenue is valued based on estimated service person hours to complete installation and quoted service labor rates and is recognized when the labor has been completed and the equipment has been accepted by the customer. Service contract revenue is valued based on estimated service person hours to complete the service and quoted service labor rates and is recognized over the contract period. Training revenue is valued based on quoted training class prices and is recognized when the customers complete the training classes or when a customer-specific training period has expired. The quoted service labor rates and training class prices are rates actually charged and billed to the Company s customers.

All other product sales with customer specific acceptance provisions are recognized upon customer acceptance. Revenue related to spare parts sales is recognized upon shipment or delivery based on the title transfer terms. Revenue related to maintenance and service contracts are recognized ratably over the duration of the contracts.

Other Comprehensive Loss

Other comprehensive loss pertains to revenues, expenses, gains, and losses that are not included in net loss, but rather are recorded directly in stockholders equity. For fiscal 2009, 2008 and 2007, other comprehensive loss consisted of foreign currency translation adjustments.

Cash and Cash Equivalents

All highly liquid investments purchased with an original maturity of three months or less are considered to be cash equivalents.

Marketable Securities

The Company accounts for its marketable securities as available-for-sale and reports them at fair market value. Fair market values, other than for auction rate securities (ARS), are based on quoted market prices. Fair market values of the majority of the Company s ARS are based on a mark-to-model approach. Other ARS are valued based on the price at which the issuer offered to repurchase such ARS in a conditional tender offer the Company received in October 2008 from the issuer. In determining the fair market value of its ARS, the Company has made assumptions related to interest rates, credit worthiness of the issuer and the Company s ability and intent to hold the investments until recovery of fair value. FSP SFAS 115-2 and SFAS 124-2 categorize losses on debt securities available-for-sale or held-to-maturity determined by management to be other-than-temporarily impaired into losses due to credit issues and losses related to all other factors. Other-than-temporary impairment (OTTI) exists when it is more likely than not that the security will mature or be sold before its amortized cost basis can be recovered. An OTTI related to credit losses should be recognized through earnings. An OTTI related to other factors should be recognized in other comprehensive income. The FSP does not amend existing recognition and measurement guidance related to other-than-temporary impairments of equity securities. Annual disclosures required in SFAS 115, FSP SFAS 115-1 and SFAS 124-1 are also required for interim periods (including the aging of securities with unrealized losses).

Allowance for Doubtful Accounts

The Company makes estimates of the uncollectibility of accounts receivable. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Accounts receivable are determined to be past due based on payment terms and are charged off after management determines that they are uncollectible.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

A rollforward of the allowance for doubtful accounts for the fiscal years ended August 29, 2009, August 30, 2008 and August 25, 2007 is as follows (in thousands):

	Balance at Beginning of Year	Recoveries	Bad Debt Expense	Adjustments	Write-offs	Balance at End of Year
Fiscal year ended August 29, 2009	$ 128	$ (21)	$ 18	$	$	$ 125
Fiscal year ended August 30, 2008	$ 196	$ (68)	$	$	$	$ 128
Fiscal year ended August 25, 2007	$ 520	$ (55)	$	$ (43)	$ (226)	$ 196

The Company collected $21,000 of receivables in fiscal 2009, $68,000 of receivables in fiscal 2008 and $55,000 in fiscal 2007 that had previously been written down to zero, resulting in credits to selling, general and administrative expenses.

Inventories

Inventories are valued at the lower of cost, determined by the first-in, first-out method, or net realizable value. The Company records provisions for inventory shrinkage and for potentially excess, obsolete and slow moving inventory. The amounts of these provisions are based upon historical loss trends, inventory levels, physical inventory and cycle count adjustments, expected product lives, forecasted sales demand and recoverability.

Property, Plant and Equipment

Building and related costs are carried at cost and depreciated on a straight-line basis over a 5 to 30-year period. Leasehold improvements are carried at cost and depreciated over a three- to fifteen-year period or the term of the underlying lease, whichever is shorter. All other property, plant and equipment assets are carried at cost and depreciated on a straight-line method over their estimated economic lives. Principal economic lives for these assets are one to seven years. Software developed for internal use is depreciated over three to five years beginning when the system is placed in service. Maintenance and repairs are expensed as incurred; significant renewals and improvements are capitalized.

Intangible Assets

The Company amortizes intangible assets on a straight-line basis over their estimated economic lives which range from two to nine years.

Impairment of Long-Lived Assets

The Company assesses the impairment of long-lived assets, whenever events or changes in circumstances indicate that the carrying amount may not be recoverable, in accordance with FASB SFAS No. 144, Accounting for the

Impairment or Disposal of Long-Lived Assets.   An asset or asset group is considered impaired if its carrying amount exceeds the undiscounted future net cash flow the asset or asset group is expected to generate. If an asset or asset group is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the asset exceeds its fair value. If estimated fair value is less than the book value, the asset is written down to the estimated fair value and an impairment loss is recognized.

The Company routinely considers whether indicators of impairment of its property and equipment assets are present. If such indicators are present, the Company determines whether the sum of the estimated undiscounted cash flows attributable to the asset in question is less than the carrying amount of the asset. If less, an impairment loss is recognized based on the excess of the carrying amount of the asset over its fair value. Fair value is determined by discounted estimated future cash flows, appraisals or other methods deemed

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

appropriate. If the asset determined to be impaired is to be held and used, the Company recognizes an impairment charge to the extent that the carrying amount of the asset exceeds its fair value. Long-lived assets amounted to $15.1 million as of August 29, 2009.

Considerable management judgment is necessary in estimating future cash flows and other factors affecting the valuation of long-lived assets, including intangible assets, which includes the operating and macroeconomic factors that may affect them. The Company uses historical financial information, internal plans and projections and industry information in making such estimates.

Income Taxes

Deferred income taxes are provided in amounts sufficient to give effect to temporary differences between financial and tax reporting. The Company accounts for tax credits as reductions of income tax expense in the year in which such credits are allowable for tax purposes.

The Company s effective income tax rate is based on income, statutory tax rates and tax planning opportunities available to it in the various jurisdictions in which it operates. The Company has established valuation allowances against its U.S. and non-U.S. net operating losses to reflect the uncertainty of its ability to fully utilize these benefits given the limited carryforward periods permitted by the various jurisdictions. The evaluation of the realizability of the Company s net operating losses requires the use of considerable management judgment to estimate the future taxable income for the various jurisdictions, for which the ultimate amounts and timing of such estimates may differ. The valuation allowance can also be impacted by changes in the tax regulations.

As of August 26, 2007, the Company adopted the provisions of the FASB Interpretation No. 48 (FIN 48), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109. The adoption of FIN 48 had no impact on our financial position or results of operations. As of August 29, 2009 and August 30, 2008, the Company had $0.5 million and $0.6 million, respectively, of liabilities recorded related to unrecognized tax benefits. Included in the liability balance as of August 29, 2009 and August 30, 2008 are approximately $0.4 million and $0.5 million, respectively, of unrecognized tax benefits that, if recognized, will affect the Company s effective tax rate. Accrued interest and penalties on these unrecognized tax benefits were $0.1 million as of both August 29, 2009 and August 30, 2008. The Company recognizes potential interest and penalties related to income tax positions, if any, as a component of provision for income taxes on the consolidated statements of operations. The Company does not anticipate that the total amount of unrecognized tax benefits will significantly change during the next twelve months.

Product Warranty

Generally, the Company warrants to the original purchaser that new equipment manufactured by it is free from defects in material and workmanship for six months to two years, depending upon the product or customer agreement. Provision is made for the estimated cost of maintaining product warranties at the time the product is sold. Special warranty provisions are also accrued for major rework campaigns.

Warranty provisions and claims for the fiscal years ended August 29, 2009, August 30, 2008 and August 25, 2007 were as follows (in thousands):

	August 29, 2009	August 30, 2008	August 25, 2007
Beginning balance	$ 2,757	$ 3,811	$ 3,964
Warranty provisions	405	1,153	1,514
Warranty claims	(1,460)	(2,207)	(1,667)
Ending Balance	$ 1,702	$ 2,757	$ 3,811

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Foreign Currency Translation

For each of our foreign operating subsidiaries the functional currency is generally its local currency. Assets and liabilities of foreign operations are translated into U.S. dollars using month-end exchange rates, and revenue and expenses are translated into U.S. dollars using average exchange rates. The effects of foreign currency translation adjustments are included as a component of accumulated other comprehensive (loss) income in stockholders equity.

Foreign currency transaction gains and losses are a result of the effect of exchange rate changes on transactions denominated in currencies other than the functional currency. Foreign currency transaction gains (losses) are included in other income, net.

Loss Per Common Share

Basic loss per share is computed by dividing net loss by the weighted average number of shares of common stock outstanding during the period. Diluted loss per common share for fiscal years 2009, 2008 and 2007 does not include the effect of potential dilutive common shares as their inclusion would be antidilutive. The number of potential dilutive common shares excluded from the computation of diluted loss per share was 3,424,000 for fiscal 2009, 3,679,000 for fiscal 2008 and 3,578,000 for fiscal 2007.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that could affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of sales revenue and expenses during the reporting period. Actual results could differ from those estimates.

Employee Stock Plans

For fiscal 2009, 2008 and 2007, the Company s results of operations reflect compensation expense for new stock options granted and vested under its stock incentive plan and employees stock purchase plan during the fiscal year and the unvested portion of previous stock option grants which vested during the fiscal year.

(2) Concentration of Risk and Financial Instruments

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist principally of cash equivalents, marketable securities and trade accounts receivable.

The Company s customers consist of microelectronics manufacturers located throughout the world. The Company performs ongoing credit evaluations of its customers financial conditions and generally requires no collateral from them. The Company maintains an allowance for doubtful accounts receivable based upon expected collectibility of all accounts receivable.

The Company invests in a variety of financial instruments such as municipal bonds, auction-rate securities, commercial paper and money market fund shares. The Company, by policy, limits the amount of credit exposure with any one financial or commercial issuer.

The carrying amount of the Company s financial instruments, which includes cash equivalents, short-term marketable securities, accounts receivable, accounts payable and accrued expenses, approximate fair value at August 30, 2008, due to their short maturities. At the end of fiscal 2009, the Company s accounts receivable included $2.0 million attributable to a past due receivable with a customer in Asia. The customer has delayed payment due to their cash flow issues and lower than expected capacity utilization. The Company is working

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

on obtaining a letter of credit for the outstanding amount with expected payment in January 2010. Management still believes that this receivable is collectible and will continue to monitor the situation closely.

As of August 29, 2009 and August 30, 2008, all marketable securities were classified as available-for-sale. The carrying amount of short-term marketable securities was $0 as of August 29, 2009 and $850,000 as of August 30, 2008. The carrying amount of long-term marketable securities was $4,458,000 as of August 29, 2009 and $6,447,000 as of August 30, 2008. The balance is net of an other-than-temporary impairment of $242,000 as of August 29, 2009 and $353,000 as of August 30, 2008. See Note 18 of the Notes to Consolidated Financial Statements for further discussion related to the impairment.

The Company manages its cash equivalents and short-term investments as a single portfolio of highly marketable securities, all of which are intended to be available to meet the Company s current cash requirements.

(3) Related Party Transactions

Prior to the transaction described below, the Company owned a 49 percent equity interest in Apprecia Technology, Inc. (Apprecia), formerly known as m FSI LTD, a Japanese joint venture company formed in 1991 among the Company, Mitsui & Co., Ltd. (Mitsui) and Mitsui s wholly owned subsidiary, Chlorine Engineers Corp., Ltd. (CEC). Apprecia is engaged in the manufacturing and distribution in the Japanese market of semiconductor equipment and products, including certain products of the Company. On May 15, 2007 (the Closing Date), the Company, CEC, Mizuho Capital Co., Ltd, (Mizuho), The Yasuda Enterprise Development III, Limited Partnership (Yasuda) and certain Apprecia managers (Apprecia Management Group) entered into a Stock Purchase Agreement (the Agreement). The Apprecia Management Group did not include any officers or employees of the Company. Under the Agreement, Apprecia paid on the Closing Date, a $4.2 million dividend to its shareholders prior to the sales contemplated in the Agreement, of which the Company received approximately $2.0 million. Under the Agreement, CEC and MBK Project Holdings Ltd. (MPH), a wholly owned subsidiary of Mitsui, sold all of their combined 51 percent equity ownership in Apprecia and the Company sold 28.4 percent of its equity ownership in Apprecia, or a total of 79.4 percent, to Yasuda, Mizuho and the Apprecia Management Group for a total purchase price of $1.8 million. On the Closing Date, the Company received total proceeds of $3.2 million, net of applicable taxes. At the end of fiscal 2007, the Company had a 20% equity ownership in Apprecia. As a result of the transaction, the Company s ownership and business relationship with Apprecia changed such that the Company no longer had the ability to exercise significant influence over Apprecia. Therefore, the Company began to account for its investment in Apprecia under the cost method after completion of the transaction. Previously, the Company accounted for its investment in Apprecia under the equity method. On the Closing Date, the Company entered into a Termination and Release Agreement with Mitsui, CEC, MPH and Apprecia, for the termination of the following agreements and any amendments thereto:

(i) the Apprecia Distribution Agreement, dated September 17, 2004, providing the Company with the exclusive rights to distribute Apprecia surface conditioning products outside of Japan,

(ii) the FSI Distribution Agreement, dated June 5, 1991, providing Apprecia with exclusive rights to distribute the Company surface conditioning products in Japan,

(iii) the Apprecia License Agreement, dated September 17, 2004, pursuant to which Apprecia granted to the Company a license to certain Apprecia intellectual property and technology,

(iv) the FSI License Agreement, dated June 5, 1991, pursuant to which the Company granted to Apprecia a license to certain of the Company s intellectual property and technology, and

(v) the Shareholders Agreement, dated June 5, 1991, among the Company, CEC and MPH related to the establishment of Apprecia.

The Company and Apprecia also entered into a new distribution agreement, with an initial five-year term, providing Apprecia with the exclusive right to sell, lease or otherwise distribute the Company s SC products in Japan.

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company sold approximately $5,355,000 in fiscal 2007 of its products in the aggregate to Apprecia as an affiliate.

(4) Lease Commitments

The Company has capital and operating lease agreements for equipment and manufacturing and office facilities. The future net minimum lease payments for all leases with noncancellable lease terms in excess of one year at August 29, 2009 are as follows (in thousands):

	Operating Leases
Fiscal Year Ending August:	
2010	$ 591
2011	371
2012	57
2013	15
2014	10
Thereafter	11
Total minimum lease payments	$ 1,055

Rental expense for all operating leases consisted of the following (in thousands):

	Fiscal Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
Rent expense for operating leases	$ 1,213	$ 1,578	$ 1,723

(5) Inventories

Inventories are summarized as follows (in thousands):

	August 29, 2009	August 30, 2008
Finished goods	$ 3,013	$ 1,999
Work in process	4,797	11,314
Raw materials and purchased parts	13,361	13,856

	$ 21,171	$ 27,169

(6) Property, Plant and Equipment

The components of property, plant and equipment are as follows (in thousands):

	August 29, 2009	August 30, 2008
Land	$ 224	$ 224
Building and leasehold improvements	33,270	33,185
Office furniture and equipment	4,200	4,240
Computer hardware and software	14,782	17,972
Manufacturing equipment	1,772	1,954
Lab equipment	19,715	20,731
Tooling	248	265
Capital programs in progress	446	505
	74,657	79,076
Less accumulated depreciation and amortization	(59,510)	(60,810)
	$ 15,147	$ 18,266

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(7) Intangible Assets

The Company amortizes intangible assets on a straight-line basis over their estimated economic lives, which range from two to nine years. The intangible assets were fully amortized in fiscal 2009.

The Company has no intangible assets with indefinite useful lives. Intangible assets as of August 29, 2009 and August 30, 2008 consist of the following (in thousands):

	As of August 29, 2009		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$ 9,150	$ 9,150	$
Patents	4,285	4,285	
License fees	500	500	
Other	420	420	
	$ 14,355	$ 14,355	$

	As of August 30, 2008		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$ 9,150	$ 9,150	$
Patents	4,285	4,224	61
License fees	500	500	
Other	420	420	
	$ 14,355	$ 14,294	$ 61

(8) Accrued Expenses

Accrued expenses are summarized as follows (in thousands):

	August 29, 2009	August 30, 2008

Salaries and benefits	$	1,507	$	1,934
Vacation		1,157		1,582
Realignment		986		1,992
Product warranty		1,702		2,757
Other		1,620		2,127
	$	6,972	$	10,392

(9) Deferred Profit

Deferred profit as of the end of the fiscal year consists of (in thousands):

	August 29, 2009		August 30, 2008	
Deferred revenue	$	2,739	$	5,439
Deferred cost of goods sold		(377)		(1,572)
Deferred profit	$	2,362	$	3,867

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(10) Income Taxes

Loss before income taxes and equity in earnings (losses) of affiliate was derived from the following sources (in thousands):

	Fiscal Year Ended		
	August 29, 2009	**August 20, 2008**	**August 25, 2007**
Domestic	$ (16,984)	$ (14,526)	$ (10,574)
Foreign	(724)	263	(3,917)
	$ (17,708)	$ (14,263)	$ (14,491)

Income tax expense is summarized as follows (in thousands):

	Fiscal Year Ended		
	August 29, 2009	**August 30, 2008**	**August 25, 2007**
Current:			
Federal	$ (83)	$	$
Foreign	(32)	(598)	102
State	31	(26)	20
	(84)	(624)	122
Deferred:			
Foreign			
State			
	$ (84)	$ (624)	$ 122

The tax effects of temporary differences that give rise to significant portions of the deferred tax assets and deferred tax liabilities at August 29, 2009 and August 30, 2008 are as follows (in thousands):

	August 29, 2009	**August 30, 2008**

Deferred tax assets:				
Inventory	$	4,180	$	6,695
Deferred profit		168		833
Accounts receivable		47		48
Property, plant and equipment, net		922		428
Credit carryforwards		6,725		6,640
Net operating loss carryforwards		70,650		61,050
Accruals		1,147		1,608
Total gross deferred tax assets		83,839		77,302
Deferred tax liabilities:				
Intangibles				23
Other, net		421		371
Investment in foreign affiliate		118		118
Total gross deferred tax liabilities		539		512
Less valuation allowance		(83,300)		(76,790)
Net deferred tax assets	$		$	

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The effective income tax expense differs from the expected statutory federal income tax as follows (in thousands):

	Fiscal Year Ended August 29, 2009	August 30, 2008	August 25, 2007
Expected federal income tax benefit	$ (6,198)	$ (4,992)	$ (5,072)
State income tax benefit before valuation allowance	(496)	(383)	(413)
Research activities credit	(225)	(250)	(390)
Nondeductable transfer pricing adjustments		809	
Valuation allowance	6,660	4,614	5,627
Stock compensation expense	169	198	207
Foreign withholding tax		48	102
Tax contingency	(32)	(709)	
Other items, net	38	41	61
	$ (84)	$ (624)	$ 122

We adopted the provisions of FIN 48 on August 26, 2007. Implementation of FIN 48 resulted in no adjustment to the liability for unrecognized tax benefits. A reconciliation of the beginning and ending amount of total gross unrecognized tax benefits is as follows (in thousands):

	Fiscal Year Ended August 29, 2009	August 30, 2008
Beginning balance	$ 583	$ 1,290
Increase related to prior year tax position		18
Decrease related to prior year tax position	(139)	(63)
Increase related to current year tax positions	68	
Settlements		(662)
Ending balance	$ 512	$ 583

The Company recorded a tax benefit of $84,000, for fiscal 2009 related primarily to R&D credit utilization in lieu of bonus depreciation and the expiration of uncertain tax positions as a result of a lapse of the applicable statute of limitations. The Company recorded a tax benefit of $624,000 in fiscal 2008 related to tax positions that were effectively settled with tax authorities during fiscal 2008, partially offset by state income tax expense. The Company recorded a tax liability of $122,000 for fiscal 2007 which was the result of foreign and state taxes.

The Company has net operating loss carryforwards for federal income tax purposes of approximately $188.0 million at August 29, 2009, which will begin to expire in fiscal 2011 through fiscal 2030 if not utilized. Of this amount, approximately $15.0 million is subject to Internal Revenue Code Section 382 limitations on utilization. This limitation is approximately $1.4 million per year. The Company has net operating loss carryforwards for state purposes of approximately $85.2 million, which will expire at various times, beginning with fiscal year 2010, if not utilized.

The Company maintains a valuation allowance to fully reserve against its net deferred tax assets due to uncertainty over the ability to realize these assets. The change in the valuation allowance during the fiscal year 2009 was $6.5 million. Included in the August 29, 2009 valuation allowance balance of $83.3 million is

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

$3.6 million, which will be recorded as a credit to stockholders equity, if it is determined in the future that this portion of the valuation allowance is no longer required.

(11) Retirement Plans

The Company has an Employee 401(k) Retirement Plan, which allows for discretionary contributions, covering eligible employees. Contributions under the plans are 3% or at the discretion of the Board of Directors. Beginning in January 2005, the Company contributed 3% of employee salaries to the 401(k). The Company contributed approximately $537,000 in fiscal 2009, $738,000 in fiscal 2008 and $877,000 in fiscal 2007.

In addition, the Company has statutory pension plans in Europe and Asia and contributed approximately $214,000 in fiscal 2009, $284,000 in fiscal 2008 and $247,000 in fiscal 2007, to such plans in aggregate.

(12) Stock Options

Stock-based compensation expense for stock options granted or vested under the Company s stock incentive plans and employees stock purchase plan (ESPP) was reflected in the statements of operations for fiscal 2009, 2008 and 2007 as follows (in thousands):

	Year Ended August 29, 2009	Year Ended August 30, 2008	Year Ended August 25, 2007
Cost of goods sold	$ 52	$ 43	$ 28
Selling, general and administrative	301	401	439
Research and development	129	121	126
Amount charged against net loss	$ 482	$ 565	$ 593

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing method. The Company uses historical data to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of an option. The Company has not made any dividend payments nor does it have plans to pay dividends in the foreseeable future. The following assumptions were used to estimate the fair value of options granted under the Company s plan and the ESPP during fiscal 2009, 2008 and 2007 using the Black-Scholes option-pricing model:

	Options			ESPP		
Fiscal Year	2009	2008	2007	2009	2008	2007
Annualized dividend yield	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

Expected stock price volatility	74.0%	69.3%	69.0%	75.5%	69.3%	69.0%
Risk free interest rate	1.6%	3.2%	4.7%	0.3%	2.3%	5.0%
Expected life (in years)	5.4	5.5	5.5	0.5	0.5	0.5

A summary of the option activity for the stock option plans for fiscal 2009 is as follows (in thousands, except price per share and contractual term):

	Number of Shares	Weighted-Average Exercise Price per Share	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at August 30, 2008	3,679	$ 6.58		
Options granted	362	0.35		
Options forfeited	(55)	1.78		
Options expired	(562)	6.46		
Options exercised				
Outstanding at August 29, 2009	3,424	$ 6.01	4.4	$ 178
Exercisable at August 29, 2009	2,932	$ 6.86	3.7	$ 18

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

There was no intrinsic value for options outstanding or exercisable at August 29, 2009 as the closing price of the Company s stock at the end of fiscal 2009 was less than the exercise price of the options outstanding or exercisable.

The weighted average grant date fair value based on the Black-Scholes option-pricing model for options granted in fiscal 2009 was $0.22 per share, in fiscal 2008 was $0.98 per share and for options granted in fiscal 2007 was $3.32 per share. There were no options exercised during fiscal 2009 or fiscal 2008. The total intrinsic value of options exercised was $108,000 during fiscal 2007.

A summary of the status of unvested option shares as of August 29, 2009 is as follows (in thousands, except fair value amounts):

	Number of Shares	Weighted-Average Grant-Date Fair Value
Unvested at August 30, 2008	428	$ 1.51
Options granted	362	0.22
Options forfeited	(55)	1.11
Options vested	(243)	1.52
Unvested at August 29, 2009	492	$ 0.60

As of August 29, 2009, there was $396,000 of total unrecognized compensation cost related to unvested share-based compensation granted under our plans. That cost is expected to be recognized over a weighted-average period of 0.7 years. The total fair value of option shares vested was $482,000 during fiscal 2009, $565,000 during fiscal 2008 and $593,000 during fiscal 2007.

The activity under stock option plans of the Company is as follows (in thousands, except per share amounts):

	Number of Shares		Weighted-Average Exercise Price per Share
	Available for Grant	Outstanding	
Activity Description			
August 26, 2006	584	3,699	$ 7.42
Granted	(173)	173	5.20
Exercised		(54)	3.50
Canceled	41	(240)	10.24
Expired Plan	(452)		
August 25, 2007		3,578	7.19

Adoption of the 2008 Omnibus Stock Plan	1,000		
Granted	(370)	370	1.59
Exercised			
Canceled		(269)	7.87
August 30, 2008	630	3,679	6.58
Additional Shares Authorized	500		
Granted	(362)	362	0.35
Exercised			
Canceled	58	(617)	6.05
August 29, 2009	826	3,424	$ 6.01

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table summarizes information with respect to options outstanding and exercisable at August 29, 2009 (number of options outstanding and exercisable in thousands):

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Options Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Exercisable	Weighted-Average Exercise Price
$0.32 - $5.00	1,558	6.5	$ 2.50	1,086	$ 3.26
$5.01 - $8.50	913	4.2	7.18	893	7.22
$8.51 - $12.00	836	1.4	10.24	836	10.24
$12.01 - $15.50	107	0.6	13.09	107	13.09
$15.51 - $16.81	10	0.4	16.81	10	16.81
$0.32 - $16.81	3,424	4.4	$ 6.01	2,932	$ 6.86

There were 3,251,000 currently exercisable options at a weighted-average exercise price of $7.12 at August 30, 2008, and 3,302,000 currently exercisable options at a weighted-average exercise price of $7.38 at August 25, 2007.

On May 22, 1997, the Company adopted a Shareholder Rights Plan (the Rights Plan). Pursuant to the Rights Plan, rights were distributed as a dividend at the rate of one preferred share purchase right (Right) for each outstanding share of common stock of the Company. The Rights Plan and related Rights expired on June 10, 2007.

(13) Employees Stock Purchase Plan

The Company s ESPP enables employees to contribute up to 10% of their wages toward the purchase of the Company s common stock at 85% of the lower of market value at the beginning or the end of the semiannual purchase period. Stockholders authorized the issuance of 1,000,000 additional shares of common stock to the ESPP in fiscal 2009.

Shares were issued on the following dates for the following prices (in thousands except per share amounts):

Date	Shares	Price per Share
December 31, 2006	75	4.39
June 30, 2007	106	2.70
December 31, 2007	111	1.53
June 30, 2008	183	1.14
December 31, 2008	314	0.26

June 30, 2009	483	0.26

As of August 29, 2009, there were 527,000 shares reserved for future employee purchases of stock under the ESPP.

(14) Segment and Other Information

Segment Information

The Company has two product lines, Surface Conditioning (SC) and POLARIS® Microlithography Systems.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company s chief operating decision-maker has been identified as the President and Chief Executive Officer. Due to the level of integration of the two product lines, the Company s chief operating decision-maker reviews consolidated operating results to make decisions about allocating resources and assessing performance for the entire Company. The two product lines are a part of one segment for the manufacture, marketing and servicing of equipment for the microelectronics industry.

Geographic Information

International sales were approximately 71% of total sales in fiscal year 2009, 76% of total sales in fiscal year 2008 and approximately 69% of total sales in fiscal year 2007. The basis for determining sales by geographic region is the location that the product is shipped to. Included in these percentages and the table below are sales to related parties (see Note 3). Sales by geographic area are summarized as follows (in thousands):

	Fiscal Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
Asia	$ 27,869	$ 33,276	$ 41,779
Europe	7,926	25,967	37,476
Other	20	24	381
Total International	35,815	59,267	79,636
Domestic	14,669	18,989	36,597
	$ 50,484	$ 78,256	$ 116,233

South Korea accounted for 43% of total sales in fiscal 2009, 25% of total sales in fiscal 2008 and 15% of total sales in fiscal 2007. Israel accounted for 10% of total sales in fiscal 2007.

Long-lived Assets

The Company does not have significant long-lived assets in foreign countries.

Customer Information

The following summarizes significant customers comprising 10% or more of the Company s trade accounts receivable as of August 29, 2009 and August 30, 2008 and 10% or more of sales for fiscal 2009, 2008 and 2007, which includes sales through affiliates to end-users:

	% of Trade Accounts Receivable as of	% of Sales for the Fiscal Year Ended

	August 29, 2009	August 30, 2008	August 29, 2009	August 30, 2008	August 25, 2007
Customer A	27%	22%	34%	19%	13%
Customer B	*	17%	*	12%	*
Customer C	*	*	*	*	11%
Customer D	*	21%	*	*	*
Customer E	22%	*	*	*	*
Customer F	10%	*	*	*	*

* Trade accounts receivable from or sales to respective customer were less than 10% as of the end of or during the fiscal year.

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(15) License Agreements

The Company, in the ordinary course of business, enters into various licensing agreements. These agreements generally provide for technology transfers between the Company and the licensors in exchange for minimum royalty payments and/or a fixed royalty to the licensors. The total accrued royalty license fees included in accrued expenses were $226,000 at August 29, 2009 and $312,000 at August 30, 2008. These agreements can generally be terminated by the Company with appropriate notice to the licensors.

(16) Supplementary Cash Flow Information

The following summarizes supplementary cash flow items (in thousands):

	Fiscal Year Ended		
	August 29, 2009	August 30, 2008	August 25, 2007
Income taxes (received) paid, net	$ (76)	$ (17)	$ 106
Interest paid, net	41	144	195
Assets acquired by a capital lease	$	$ 442	$ 1,687

(17) Cost Reductions and Realignment

In the second quarter of fiscal 2009, the Company committed to a plan of additional cost reduction actions, including the reduction of headcount, salary reductions and scheduled plant shutdowns. The cost reduction actions were due to the Company continuing to be impacted by the global economic slowdown and in particular the reduced demand for the Company s products. A total of 111 positions were eliminated of which 37 were manufacturing positions, 37 were sales, service and marketing positions, 8 were administrative positions and 29 were engineering positions. Severance and outplacement costs, net of change in estimate, recorded in fiscal 2009 were allocated as follows: $1,133,000 to selling, general and administrative expense, $875,000 to research and development expense and $604,000 to cost of goods sold.

The fiscal 2009 severance and outplacement costs are summarized as follows (in thousands):

	Amount Charged Fiscal 2009	Amount Paid through August 29, 2009	Accrual at August 29, 2009
Selling, general and administrative expenses	$ 1,133	$ 739	$ 394
Research and development expenses	875	534	341
Cost of goods sold	604	353	251

Total	$	2,612	$	1,626	$	986

In fiscal 2008, the Company committed to a plan to reduce its headcount by approximately 60 positions, or about 14% of the Company s global workforce from the end of the third quarter of fiscal 2008. The plan was implemented in September 2008. In conjunction with the staff reductions, the Company s European and United States sales and service organizations were consolidated to better support the customer base in these regions. Also, the Company refocused its remaining Allen, TX and Chaska, MN based engineering resources toward products which the Company believes will provide the most significant opportunity for near-term revenue and future market share gains. A total of 63 positions were eliminated in September 2008 of which 19 were manufacturing positions, 19 were sales, service and marketing positions, 5 were administration positions and 20 were engineering positions. Severance and outplacement costs recorded in fiscal 2008 were allocated as follows: $1,314,000 to selling, general and administrative expense, $536,000 to research and development expense and $142,000 to cost of goods sold.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The fiscal 2008 severance and outplacement costs are summarized as follows (in thousands):

	Amount Charged Fiscal 2008		Amount Paid through August 29, 2009		Accrual at August 29, 2009
Selling, general and administrative expenses	$	1,314	$	1,314	$
Research and development expenses		536		536	
Cost of goods sold		142		142	
Total severance and outplacement costs	$	1,992	$	1,992	$

The accruals were paid in fiscal 2009.

In fiscal 2007, the Company implemented cost reduction actions including a 25% reduction in headcount to approximately 430 employees and other operating cost initiatives. The cost reduction actions were related to industry conditions in the semiconductor device and thin film head segments that the Company serves, coupled with a delay in certain customer-specific equipment purchases. A total of 136 positions were eliminated in connection with this reduction of which 61 were manufacturing positions, 28 were sales, service and marketing positions, 13 were administration positions and 34 were engineering positions. The terminations all occurred in fiscal 2007. Severance and outplacement costs recorded in fiscal 2007 were allocated as follows: $923,000 to selling, general and administrative expense, $592,000 to research and development expense and $296,000 to cost of goods sold.

The fiscal 2007 severance and outplacement costs are summarized as follows (in thousands):

	Amount Charged Fiscal 2007		Amount Paid through August 30, 2008		Accrual at August 30, 2008
Selling, general and administrative expenses	$	923	$	923	$
Research and development expenses		592		592	
Cost of goods sold		296		296	
Total severance and outplacement costs	$	1,811	$	1,811	$

The accruals were paid in fiscal 2008.

(18) Marketable Securities and Impairment of Investment

As of August 29, 2009, the Company had investments in ARS reported at a fair value of $4.5 million after reflecting a $0.2 million other than temporary impairment against $4.7 million par value. The other than temporary impairment was recorded in fiscal 2008. The Company valued the majority of ARS using a mark-to-model approach that relies on discounted cash flows, market data and inputs derived from similar instruments. This model takes into account, among other variables, the base interest rate, credit spreads, downgrade risks and default/recovery risk, the estimated time required to work out the disruption in the traditional auction process and its effect on liquidity, and the effects of insurance and other credit enhancements. However, the Company valued certain ARS based on the price at which the issuer offered to repurchase such ARS in a conditional tender offer received by the Company in October 2008 from the issuer.

The ARS held by the Company are marketable securities with long-term stated maturities for which the interest rates are reset every 28 days through an auction process and at the end of each reset period, investors can sell or continue to hold the securities at par. The auctions have historically provided a liquid market for these securities as investors historically could readily sell their investments at auction. Due to the liquidity issues experienced in global credit and capital markets, the ARS held by the Company have experienced

FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

multiple failed auctions, beginning on February 19, 2008, as the amount of securities submitted for sale has exceeded the amount of purchase orders. During the second quarter of fiscal 2008, the Company reclassified $8.5 million of ARS from current marketable securities to long-term marketable securities on the condensed consolidated balance sheet due to difficulties encountered at auction and the conditions in the general debt markets creating uncertainty as to when successful auctions may be reestablished. During fiscal 2008 $0.8 million of ARS were partially redeemed. An additional $3.0 million were redeemed in fiscal 2009.

The $4.7 million par value ARS held by the Company are backed by student loans and are collateralized, insured and guaranteed by the United States Federal Department of Education and are classified as long-term. All of the ARS held by the Company continue to carry investment grade ratings and have not experienced any payment defaults. ARS that did not successfully auction, reset to the maximum interest rate as prescribed in the underlying indenture and all of the Company s holdings continue to be current with their interest payments. If uncertainties in the credit and capital markets continue, these markets deteriorate further or any ARS the Company holds are downgraded by the rating agencies, the Company may be required to recognize additional impairment charges.

The Company categorizes its assets and liabilities into one of three levels based on the assumptions (inputs) used in valuing the asset or liability. Level 1 provides the most reliable measure of fair value, while Level 3 generally requires significant management judgment. The three levels are defined as follows:

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

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

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.

The Company valued its ARS based on level 3 inputs in which values are based on prices or valuation techniques that require inputs that are both unobservable and significant to the overall fair value measurement. These level 3 inputs reflect management s own assumptions about the assumptions a market participant would use in pricing the ARS.

(19) Contingencies

In late calendar 2006, the Company determined that certain of its replacement valves, pumps and heaters could fall within the scope of United States export licensing regulations to products that could be used in connection with chemical weapons processes. The Company determined that these regulations require it to obtain licenses to ship some of its replacement spare parts, spare parts kits and assemblies to customers in certain controlled countries as defined in the export licensing regulations. During the second quarter of fiscal 2007, the Company was granted licenses to ship replacement spare parts, spare parts kits and assemblies to all customers in the controlled countries where the Company conducts business.

The applicable export licensing regulations frequently change. Moreover, the types and categories of products that are subject to export licensing are often described in the regulations in general terms and could be subject to differing interpretations.

In the second quarter of fiscal 2007, the Company made a voluntary disclosure to the United States Department of Commerce to clarify its licensing practices and to review its practices with respect to prior sales of certain replacement valves, pumps and heaters to customers in several controlled countries as defined in the licensing regulations.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

In October 2009, the Company entered into a settlement agreement with the Office of Export Enforcement for $450,000. The Company will pay $5,000 per month for ten months beginning in November 2009. The remaining $400,000 owed under the settlement will be suspended for 12 months. If the Company does not commit any export violations during the 12-month period, it will be released from further payment, including the suspended $400,000.

(20) Share Repurchase Plan

In October 2008, the Company authorized the repurchase of up to $3 million of the Company s common stock to be effected from time to time in transactions in the public markets or in private purchases. The timing and extent of any repurchases will depend upon market conditions, the trading price of the Company s shares and other factors, subject to the restrictions relating to volume, price and timing of share repurchases under applicable law. The repurchase program may be modified, suspended or terminated at any time by the Company without notice. The Company did not repurchase any of its common stock during fiscal 2009.

(21) Liquidity

As of August 29, 2009, the Company had $12.0 million of cash, cash equivalents, restricted cash and marketable securities, of which $4.5 million are classified as long-term due to the lack of liquidity of the ARS as discussed in Note 18. During fiscal 2009, the Company used approximately $10.1 million for operations, which included the liquidation of approximately $2.4 million of life insurance investments. The cash usage was primarily related to funding the loss from operations.

In light of its current financial condition, the Company recognized the need to reduce its use of cash and has implemented a number of cost reduction steps, as discussed further in Note 17. The Company s actions in fiscal 2009 are expected to lower the Company s annual operating expenses.

The Company currently does not have any revolving line of credit or other form of debt financing. If the economic environment does not improve in early fiscal 2010, and, not withstanding the Company s cash management initiatives, if more cash is needed to fund the Company than expected, the Company may need to take additional actions. These actions could include entering into a sale-leaseback arrangement for its facility in Chaska, Minnesota, entering into an asset-based lending arrangement, borrowing up to $3.2 against or liquidating its remaining life insurance investments of $3.5 million and/or borrowing up to 50% against or selling some or all of its currently illiquid ARS, possibly at a loss, selling additional equity or other cash generating actions. If the Company must engage in any of the foregoing cash generating actions, there is no assurance that any such actions will be available to the Company, particularly those relating to third-party financing arrangements. Further, there is no assurance on the amount of cash that may be generated as a result of these actions, or whether the amount of cash received will be sufficient to cover the Company s operating expenses at such time. The sale of additional equity would likely result in additional dilution to the Company s shareholders.

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Report of Independent Registered Public Accounting Firm

The Board of Directors and Stockholders
FSI International, Inc.:

We have audited the accompanying consolidated balance sheets of FSI International, Inc. and subsidiaries (the Company) as of August 29, 2009 and August 30, 2008, and the related consolidated statements of operations, stockholders equity and comprehensive loss, and cash flows for each of the years in the three-year period ended August 29, 2009. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of FSI International, Inc. and subsidiaries as of August 29, 2009 and August 30, 2008, and the results of their operations and their cash flows for each of the years in the three-year period ended August 29, 2009, in conformity with U.S. generally accepted accounting principles.

/s/ KPMG LLP

Minneapolis, Minnesota
November 12, 2009

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Data for the fiscal quarters of our last two fiscal years is as follows (in thousands, except per share data):

Quarterly Data

	First Quarter (b), (c)	Second Quarter (a), (b), (c), (d)	Third Quarter (b), (c), (d)	Fourth Quarter (a), (b), (c), (d)
		(Unaudited)		
2009				
Sales	$ 12,244	$ 8,640	$ 15,424	$ 14,176
Gross margin	4,627	1,207	4,313	6,280
Operating loss	(5,423)	(9,495)	(2,669)	(164)
Net loss	(5,317)	(9,427)	(2,808)	(73)
Diluted net loss per common share	$ (0.17)	$ (0.30)	$ (0.09)	$ 0.00
2008				
Sales	$ 22,439	$ 21,423	$ 20,331	$ 14,063
Gross margin	8,603	10,210	10,479	3,694
Operating loss	(2,418)	(1,482)	(1,632)	(9,457)
Net loss	(2,132)	(1,016)	(1,404)	(9,087)
Diluted net loss per common share	$ (0.07)	$ (0.03)	$ (0.05)	$ (0.30)

(a) During fiscal 2009 and 2008, the Company recorded severance and outplacement costs as follows:

	First Quarter	Second Quarter	Quarter Third	Quarter Fourth	Fiscal 2009
Cost of sales	$	$ 698	$	$ (94)	$ 604
Selling, general and administrative expenses		1,168		(35)	1,133
Research and development expenses		967		(92)	875
Total	$	$ 2,833	$	$ (221)	$ 2,612

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal 2008
Cost of sales	$	$	$	$ 142	$ 142
Selling, general and administrative expenses				1,314	1,314
Research and development expenses				536	536
Total	$	$	$	$ 1,992	$ 1,992

(b) During fiscal 2009 and 2008, the Company recorded stock-based compensation expense as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal 2009
Cost of sales	$ 10	$ 9	$ 13	$ 20	$ 52
Selling, general and administrative expenses	79	69	84	69	301
Research and development expenses	20	13	34	62	129
Total	$ 109	$ 91	$ 131	$ 151	$ 482

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	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal 2008
Cost of sales	$ 2	$ 12	$ 17	$ 12	$ 43
Selling, general and administrative expenses	112	91	110	88	401
Research and development expenses	23	33	41	24	121
Total	$ 137	$ 136	$ 168	$ 124	$ 565

(c) During fiscal 2009 and 2008, the Company had sales of POLARIS systems product inventory with an original cost that had previously been written down to zero as follows:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Fiscal Year
Fiscal 2009	$ 99	$ 158	$ 90	$ 270	$ 617
Fiscal 2008	$ 339	$ 330	$ 185	$ 95	$ 949

(d) During the second quarter and third quarter of fiscal 2009, the Company recorded a gain of $74,000 and $36,000, respectively, associated with ARS redemptions. During the fourth quarter of fiscal 2008, the Company recorded an other than temporary impairment related to its ARS of $0.4 million.

The Company s fiscal quarters are generally 13 weeks, all ending on a Saturday. The fiscal year ends on the last Saturday in August and consists of 52 or 53 weeks.

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ITEM 9. *CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE*

None.

ITEM 9A. *CONTROLS AND PROCEDURES*

MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

The management of the Company is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Rule 13a-15(f) under the Exchange Act of 1934 (the Exchange Act). The Company s internal control system was designed to provide reasonable assurance to the Company s management and board of directors regarding the preparation and fair presentation of published financial statements. Under the supervision and with the participation of management, including our Chairman and Chief Executive Officer and Chief Financial Officer, we conducted an assessment of the effectiveness of our internal control over financial reporting as of August 29, 2009. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in *Internal Control Integrated Framework*.

Based on our assessment using the criteria set forth by COSO in *Internal Control Integrated Framework*, management concluded that our internal control over financial reporting was effective as of August 29, 2009. This annual report does not include an attestation report of KPMG LLP (KPMG), our independent registered public accounting firm, regarding internal control over financial reporting. Management s report was not subject to attestation by KPMG pursuant to temporary rules of the SEC that permit us to provide only management s report in this annual report.

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Exchange Act). Based on this evaluation, the principal executive officer and principal financial officer concluded that our disclosure controls and procedures 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.

Changes in Internal Controls Over Financial Reporting

There were no changes in our internal control over financial reporting during our most recently completed fiscal quarter that have materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

ITEM 9B. *OTHER INFORMATION*

None.

PART III

Certain information required by Part III is incorporated by reference to our definitive proxy statement for the annual meeting of shareholders to be held on January 20, 2010 and which will be filed with the Securities and Exchange Commission pursuant to Regulation 14A within 120 days after August 29, 2009.

Except for those portions specifically incorporated in this report by reference to our proxy statement for the annual meeting of shareholders to be held on January 20, 2010, no other portions of the proxy statement are deemed to be filed as part of this Report on Form 10-K.

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ITEM 10. ***DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT***

The information concerning our directors and our board committees required by this item is incorporated by reference to the information under the captions Election of Directors and Compliance with Section 16(a) of the Securities and Exchange Act of 1934 in our proxy statement for the annual meeting of shareholders to be held on January 20, 2010. For information concerning executive officers, see Item 4A of this Form 10-K Report.

Code of Business Conduct and Ethics

We have adopted a code of business conduct and ethics applicable to all of our directors and employees, including our principal executive officer, principal financial officer, controller and other employees performing similar functions. A copy of this code of business conduct and ethics is available on our website at www.fsi-intl.com.

We intend to disclose any waiver of our code of business conduct and ethics for our directors or executive officers in future Form 8-K filings within four business days following the date of such waiver. We also intend to post on our website at www.fsi-intl.com any amendment to, or waiver from, a provision of our code of business conduct and ethics that applies to our principal executive officer, principal financial officer, controller and other employees performing similar functions within four business days following the date of such amendment or waiver.

ITEM 11. ***EXECUTIVE COMPENSATION***

The information required by this item is incorporated by reference to the information under the captions Election of Directors and Compensation of Executive Officers in our proxy statement for the annual meeting of shareholders to be held on January 20, 2010.

ITEM 12. ***SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS***

The information required by this item is incorporated by reference to the information under the captions Security Ownership of Management and Certain Beneficial Owners and Equity Compensation Plan Information in our proxy statement for the annual meeting of shareholders to be held on January 20, 2010.

ITEM 13. ***CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS***

The information required by this item is incorporated by reference to the information under the caption Interests of Management and Others in Certain Transactions in our proxy statement for the annual meeting of shareholders to be held on January 20, 2010.

ITEM 14. ***PRINCIPAL ACCOUNTANT FEES AND SERVICES***

The information required by this item is incorporated by reference to the information under the captions Independent Registered Public Accountant Fees and Auditor Independence in our proxy statement for the annual meeting of shareholders to be held on January 20, 2010.

PART IV

ITEM 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

		Page Number in this Report
(a)(1)	Index to Financial Statements	
	Consolidated Statements of Operations Years ended August 29, 2009, August 30, 2008 and August 25, 2007	34
	Consolidated Balance Sheets August 29, 2009 and August 30, 2008	35
	Consolidated Statements of Stockholders Equity and Comprehensive Loss Years ended August 29, 2009, August 30, 2008 and August 25, 2007	36
	Consolidated Statements of Cash Flows Years ended August 29, 2009, August 30, 2008 and August 25, 2007	37
	Notes to Consolidated Financial Statements	38
	Report of Independent Registered Public Accounting Firm	57
	Quarterly financial data for fiscal 2009 and 2008 (unaudited)	58
(a)(2)	Financial Statement Schedules	
	All schedules are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto	

(a)(3) *Exhibits*

2.1	Agreement and Plan of Reorganization, dated as of January 21, 1999 among FSI International, Inc., BMI International, Inc. and YieldUP International Corporation.(6)
2.2	Agreement and Plan of Reorganization by and Among FSI International, Inc., Spectre Acquisition Corp., and Semiconductor Systems, Inc.(1)
2.3	Asset Purchase Agreement dated as of June 9, 1999 between FSI International, Inc. and The BOC Group, Inc.(7)
3.1	Restated Articles of Incorporation of the Company.(2)
3.2	Restated and Amended By-Laws.(14)
3.3	Articles of Amendment of Restated Articles of Incorporation.(8)
10.1	FSI International, Inc. 1997 Omnibus Stock Plan (as amended and restated April 2001).(12)
10.2	Form of Incentive Stock Option Agreement for the FSI International, Inc. 1997 Omnibus Stock Plan, as amended.(15)
10.3	Form of Incentive Stock Option Agreement for Outside Directors for the FSI International, Inc. 1997 Omnibus Stock Plan, as amended.(15)
10.4	FSI International, Inc. 2008 Omnibus Stock Plan.(17)
10.5	Amended and Restated Employees Stock Purchase Plan.(17)
10.6	Management Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Donald S. Mitchell. (Identical Management Agreements were entered into on March 28, 2008 between the Company and each of Benno G. Sand, Patricia M. Hollister and John C. Ely. These Management Agreements have been omitted but will be filed if requested in writing by the Commission)(18)
10.7	Severance Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Benno G. Sand.(18)

10.8	Employment Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Donald S. Mitchell.(18)
10.9	Amended and Restated Summary of Terms of Employment entered into as of March 28, 2008 between FSI International and Donald S. Mitchell.(18)

10.10	Severance Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Patricia M. Hollister. (An identical Severance Agreement was entered into on March 28, 2008 between the Company and John C. Ely. This Severance Agreement has been omitted but will be filed if requested in writing by the Commission.)(18)
10.11	License Agreement, dated October 15, 1991, between the Company and Texas Instruments Incorporated.(3)
10.12	Amendment No. 1, dated April 10, 1992, to the License Agreement, dated October 15, 1991, between the Company and Texas Instruments Incorporated.(3)
10.13	Amendment effective October 1, 1993 to the License Agreement, dated October 15, 1991 between the Company and Texas Instruments Incorporated.(4)
10.14	Amended and Restated Directors Nonstatutory Stock Option Plan.(5)
10.15	Management Agreement between FSI International, Inc. and Donald S. Mitchell, effective as of January 2, 2001.(Similar agreements between the Company and its executive officers have been omitted but will be filed if requested in writing by the commission.)(11)#
10.16	Summary of Employment Arrangement between the Company and Don Mitchell dated December 12, 1999.(10)#
10.17	Employment Agreement entered into as of December 12, 1999 by and between FSI International, Inc. and Donald S. Mitchell.(9)#
10.18	Agreement made and entered into as of March 4, 2001 by and between FSI International, Inc. and Benno G. Sand.(13)#
10.19	Termination and Release Agreement dated as of May 15, 2007 with Mitsui & Co., Ltd., Chlorine engineers Corp., Ltd., MBK Project Holdings Ltd. and Apprecia.(16)
10.20	Stock Purchase Agreement dated as of May 15, 2007 by an among FSI International, Inc., MBK Project Holdings Ltd., Chlorine Engineers Corp. Ltd., Yasuda Enterprise Development III Limited Partnership, Mizuho Capital Co., Ltd., Mr. Hideki Kawai, Mr. Takanori Yoshioka and Mr. Satoshi Shikami. (exhibits omitted)(16)
21.0	Subsidiaries of the Company. (filed herewith)
23.0	Consent of KPMG LLP, independent registered public accounting firm. (filed herewith)
24.0	Powers of Attorney from the Directors of FSI International, Inc. (filed herewith)
31.1	Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
31.2	Certification by Principal Financial and Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. (filed herewith)
32.1	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. (filed herewith)

Identified exhibit is a management contract, compensation plan or arrangement.

(1) Filed as an Exhibit to the Company s Registration Statement on Form S-4 (as amended) dated March 21, 1996, SEC File No. 333-1509 and incorporated by reference.

(2) Filed as an Exhibit to the Company s Report on Form 10-Q for the quarter ended February 24, 1990, SEC File No. 0-17276, and incorporated by reference.

(3) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 29, 1992, File No. 0-17276, and incorporated by reference.

(4) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 28, 1993, SEC File No. 0-17276, and incorporated by reference.

(5) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended May 28, 1994, SEC File No. 0-17276, and incorporated by reference.

(6) Filed as an Exhibit to the Company s Report on Form 8-K, filed by the Company on January 27, 1999, SEC File No. 0-17276 and incorporated by reference.

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(7) Filed as an Exhibit to the Company s Report on Form 8-K, filed by the Company on June 24, 1999, SEC File No. 0-17276 and incorporated by reference.

(8) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 28, 1999, SEC File No. 0-17276, and incorporated by reference.

(9) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended February 26, 2000, SEC File No. 0-17276 and incorporated by reference.

(10) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 26, 2000, SEC File No. 0-17276 and incorporated by reference.

(11) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended February 24, 2001, SEC File No. 0-17276 and incorporated by reference.

(12) Filed as an Exhibit to the Company s Registration Statement on Form S-8, filed by the Company on March 28, 2003, SEC File No. 333-104088 and incorporated by reference.

(13) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 31, 2002, SEC File No. 0-17276 and incorporated by reference.

(14) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended February 23, 2002, SEC File No. 0-17276 and incorporated by reference.

(15) Filed as an Exhibit to the Company s Current Report on Form 8-K, filed by the Company on October 20, 2004, SEC File No. 0-17276 and incorporated by reference.

(16) Filed as an Exhibit to the Company s Report on Form 10-Q for the quarter ended May 26, 2007, SEC File No. 0-17276 and incorporated by reference.

(17) Filed as an Exhibit to the Company s Registration Statement on Form S-8, filed by the Company on March 21, 2008, SEC File No. 333-149852 and incorporated by reference.

(18) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended March 1, 2008, SEC File No. 0-17276 and incorporated by reference.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

FSI INTERNATIONAL, INC.

By: /s/ Donald S. Mitchell

Donald S. Mitchell, Chairman and
Chief Executive Officer
(Principal Executive Officer)

Dated: November 12, 2009

By: /s/ Patricia M. Hollister

Patricia M. Hollister, Chief Financial Officer
(Principal Financial and Accounting Officer)

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons, constituting a majority of the Board of Directors, on behalf of the Registrant and in the capacities and on the dates indicated.

James A. Bernards, Director*
Terrence W. Glarner, Director*
Willem D. Maris, Director*
Donald S. Mitchell, Director*
David V. Smith, Director*

*By: /s/ Patricia M. Hollister

Patricia M. Hollister, Attorney-in-fact

Dated: November 12, 2009

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INDEX TO EXHIBITS

Exhibit	Description	Method of Filing
2.1	Agreement and Plan of Reorganization, dated as of January 21, 1999 among FSI International, Inc., BMI International, Inc. and YieldUP International Corporation.(6)	Incorporated by reference
2.2	Agreement and Plan of Reorganization by and Among FSI International, Inc., Spectre Acquisition Corp., and Semiconductor Systems, Inc.(1)	Incorporated by reference
2.3	Asset Purchase Agreement dated as of June 9, 1999 between FSI International, Inc. and The BOC Group, Inc.(7)	Incorporated by reference
3.1	Restated Articles of Incorporation of the Company.(2)	Incorporated by reference
3.2	Restated and Amended By-Laws.(14)	Incorporated by reference
3.3	Articles of Amendment of Restated Articles of Incorporation.(8)	Incorporated by reference
10.1	FSI International, Inc. 1997 Omnibus Stock Plan (as amended and restated April 2001).(12)	Incorporated by reference
10.2	Form of Incentive Stock Option Agreement for the FSI International, Inc. 1997 Omnibus Stock Plan, as amended.(15)	Incorporated by reference
10.3	Form of Incentive Stock Option Agreement for Outside Directors for the FSI International, Inc. 1997 Omnibus Stock Plan, as amended.(15)	Incorporated by reference
10.4	FSI International, Inc. 2008 Omnibus Stock Plan.(17)	Incorporated by reference
10.5	Amended and Restated Employees Stock Purchase Plan.(17)	Incorporated by reference
10.6	Management Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Donald S. Mitchell. (Identical Management Agreements were entered into on March 28, 2008 between the Company and each of Benno G. Sand, Patricia M. Hollister and John C. Ely. These Management Agreements have been omitted but will be filed if requested in writing by the Commission)(18)	Incorporated by reference
10.7	Severance Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Benno G. Sand.(18)	Incorporated by reference
10.8	Employment Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Donald S. Mitchell.(18)	Incorporated by reference
10.9	Amended and Restated Summary of Terms of Employment entered into as of March 28, 2008 between FSI International and Donald S. Mitchell.(18)	Incorporated by reference
10.10	Severance Agreement entered into as of March 28, 2008, by and between FSI International, Inc. and Patricia M. Hollister. (An identical Severance Agreement was entered into on March 28, 2008 between the Company and John C. Ely. This Severance Agreement has been omitted but will be filed if requested in writing by the Commission.)(18)	Incorporated by reference
10.11	License Agreement, dated October 15, 1991, between the Company and Texas Instruments Incorporated.(3)	Incorporated by reference
10.12	Amendment No. 1, dated April 10, 1992, to the License Agreement, dated October 15, 1991, between the Company and Texas Instruments Incorporated.(3)	Incorporated by reference
10.13	Amendment effective October 1, 1993 to the License Agreement, dated October 15, 1991 between the Company and Texas Instruments Incorporated.(4)	Incorporated by reference

10.14	Amended and Restated Directors Nonstatutory Stock Option Plan.(5)	Incorporated by reference
10.15	Management Agreement between FSI International, Inc. and Donald S. Mitchell, effective as of January 2, 2001. (Similar agreements between the Company and its executive officers have been omitted but will be filed if requested in writing by the commission.)(11)#	Incorporated by reference

Exhibit	Description	Method of Filing
10.16	Summary of Employment Arrangement between the Company and Don Mitchell dated December 12, 1999.(10)#	Incorporated by reference
10.17	Employment Agreement entered into as of December 12, 1999 by and between FSI International, Inc. and Donald S. Mitchell.(9)#	Incorporated by reference
10.18	Agreement made and entered into as of March 4, 2001 by and between FSI International, Inc. and Benno G. Sand.(13)#	Incorporated by reference
10.19	Termination and Release Agreement dated as of May 15, 2007 with Mitsui & Co., Ltd., Chlorine engineers Corp., Ltd., MBK Project Holdings Ltd. and Apprecia.(16)	Incorporated by reference
10.20	Stock Purchase Agreement dated as of May 15, 2007 by an among FSI International, Inc., MBK Project Holdings Ltd., Chlorine Engineers Corp. Ltd., Yasuda Enterprise Development III Limited Partnership, Mizuho Capital Co., Ltd., Mr. Hideki Kawai, Mr. Takanori Yoshioka and Mr. Satoshi Shikami. (exhibits omitted)(16)	Incorporated by reference
21.0	Subsidiaries of the Company.	Filed herewith
23.0	Consent of KPMG LLP, independent registered public accounting firm.	Filed herewith
24.0	Powers of Attorney from the Directors of FSI International, Inc.	Filed herewith
31.1	Certification by Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act.	Filed herewith
31.2	Certification by Principal Financial and Accounting Officer Pursuant to Section 302 of the Sarbanes-Oxley Act.	Field herewith
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.	Filed herewith

\# Identified exhibit is a management contract, compensation plan or arrangement.

(1) Filed as an Exhibit to the Company s Registration Statement on Form S-4 (as amended) dated March 21, 1996, SEC File No. 333-1509 and incorporated by reference.

(2) Filed as an Exhibit to the Company s Report on Form 10-Q for the quarter ended February 24, 1990, SEC File No. 0-17276, and incorporated by reference.

(3) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 29, 1992, File No. 0-17276, and incorporated by reference.

(4) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 28, 1993, SEC File No. 0-17276, and incorporated by reference.

(5) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended May 28, 1994, SEC File No. 0-17276, and incorporated by reference.

(6) Filed as an Exhibit to the Company s Report on Form 8-K, filed by the Company on January 27, 1999, SEC File No. 0-17276 and incorporated by reference.

(7) Filed as an Exhibit to the Company s Report on Form 8-K, filed by the Company on June 24, 1999, SEC File No. 0-17276 and incorporated by reference.

(8) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 28, 1999, SEC File No. 0-17276, and incorporated by reference.

(9) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended February 26, 2000, SEC File No. 0-17276 and incorporated by reference.

(10) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 26, 2000, SEC File No. 0-17276 and incorporated by reference.

(11) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended February 24, 2001, SEC File No. 0-17276 and incorporated by reference.

(12) Filed as an Exhibit to the Company s Registration Statement on Form S-8, filed by the Company on March 28, 2003, SEC File No. 333-104088 and incorporated by reference.

(13) Filed as an Exhibit to the Company s Report on Form 10-K for the fiscal year ended August 31, 2002, SEC File No. 0-17276 and incorporated by reference.

(14) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended February 23, 2002, SEC File No. 0-17276 and incorporated by reference.

(15) Filed as an Exhibit to the Company s Current Report on Form 8-K, filed by the Company on October 20, 2004, SEC File No. 0-17276 and incorporated by reference.

(16) Filed as an Exhibit to the Company s Report on Form 10-Q for the quarter ended May 26, 2007, SEC File No. 0-17276 and incorporated by reference.

(17) Filed as an Exhibit to the Company s Registration Statement on Form S-8, filed by the Company on March 21, 2008, SEC File No. 333-149852 and incorporated by reference.

(18) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended March 1, 2008, SEC File No. 0-17276 and incorporated by reference.