
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark one)

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

For the quarterly period ended September 25, 2004

or

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

For the transition period from to

Commission file number: 000-50307

FormFactor, Inc.

(Exact name of registrant as specified in its charter)

Delaware	13-3711155
<i>(State or other jurisdiction of incorporation or organization)</i>	<i>(I.R.S. Employer Identification No.)</i>

7005 Southfront Road, Livermore, California 94551

(Address of principal executive offices, including zip code)

(925) 290-4000

(Registrant's telephone number, including area code)

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

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

The number of shares of the registrant's common stock, par value \$0.001 per share, outstanding as of October 31, 2004 was 38,483,078 shares.

FormFactor, Inc.
Form 10-Q for the Quarterly Period Ended September 25, 2004
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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

FORMFACTOR, INC.

CONDENSED CONSOLIDATED INCOME STATEMENTS

(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Revenues	\$26,076	\$51,377	\$66,839	\$131,649
Cost of revenues	13,213	25,471	34,482	63,655
Stock-based compensation	163	154	451	466
Gross margin	12,700	25,752	31,906	67,528
Operating expenses:				
Research and development (1)	3,966	5,555	11,322	14,420
Selling, general and administrative (1)	4,980	7,904	13,471	20,640
Stock-based compensation	638	455	1,897	1,571
Total operating expenses	9,584	13,914	26,690	36,631
Operating income	3,116	11,838	5,216	30,897
Interest income	289	635	625	1,740
Interest expense	(11)	—	(38)	—
Other income (expense), net	242	(156)	193	(798)
	520	479	780	942
Income before income taxes	3,636	12,317	5,996	31,839
Provision for income taxes	(1,395)	(4,820)	(2,300)	(12,483)
Net income	2,241	7,497	3,696	19,356
Preferred stock dividend	—	—	(2,510)	—
Net income available to common stockholders	\$ 2,241	\$ 7,497	\$ 1,186	\$ 19,356
Net income per share:				
Basic	\$ 0.07	\$ 0.20	\$ 0.07	\$ 0.52
Diluted	\$ 0.06	\$ 0.19	\$ 0.04	\$ 0.48
Weighted-average number of shares used in per share calculations:				
Basic	34,117	37,632	16,629	37,584
Diluted	38,044	40,499	33,133	40,490
(1) Amounts exclude stock-based compensation expense as follows:				
Research and development	235	216	657	606
Selling, general and administrative	403	239	1,240	965
Total	\$ 638	\$ 455	\$ 1,897	\$ 1,571

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

FORMFACTOR, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share amounts)
(Unaudited)

	December 27, 2003	September 25, 2004
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 116,305	\$ 66,226
Marketable securities	62,965	114,994
Accounts receivable, net of allowance for doubtful accounts of \$103 in 2003 and \$98 in 2004	19,698	33,642
Inventories, net	8,025	10,050
Deferred tax assets	2,825	2,825
Prepaid expenses and other current assets	2,744	3,795
Total current assets	<u>212,562</u>	<u>231,532</u>
Restricted cash	2,550	2,250
Property and equipment, net	20,495	47,184
Deferred tax assets	1,202	1,202
Other assets	356	272
Total assets	<u>\$237,165</u>	<u>\$282,440</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 10,579	\$ 17,724
Accrued liabilities	10,134	15,089
Deferred revenue and customer advances	1,005	1,402
Total current liabilities	21,718	34,215
Deferred revenue and customer advances	433	254
Total liabilities	<u>22,151</u>	<u>34,469</u>
Commitments and contingencies (Note 6)		
Stockholders' equity:		
Common stock, \$0.001 par value	37	39
Additional paid-in capital	226,592	237,177
Notes receivable from stockholders	(661)	—
Deferred stock-based compensation	(7,902)	(5,279)
Accumulated other comprehensive loss	(4)	(274)
Retained earnings (accumulated deficit)	(3,048)	16,308
Total stockholders' equity	<u>215,014</u>	<u>247,971</u>
Total liabilities and stockholders' equity	<u>\$237,165</u>	<u>\$282,440</u>

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

FORMFACTOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited, in thousands)

	Nine Months Ended	
	September 27, 2003	September 25, 2004
Cash flows from operating activities:		
Net income	\$ 3,696	\$ 19,356
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,834	4,422
Stock-based compensation expense	2,348	2,037
Tax benefit from employee stock option plans	—	3,221
Interest income from stockholders' notes receivable	(145)	—
Reduction in allowance for doubtful accounts	(150)	(5)
Provision for excess and obsolete inventories	2,531	2,484
Loss on disposal of property and equipment	10	—
Changes in assets and liabilities:		
Accounts receivable	(3,796)	(13,940)
Inventories	(5,860)	(4,510)
Prepaid and other current assets	1,003	(1,074)
Accounts payable	2,040	(537)
Accrued liabilities	1,132	4,972
Deferred revenues and customer advances	241	218
Net cash provided by operating activities	<u>6,884</u>	<u>16,644</u>
Cash flows from investing activities:		
Acquisition of property and equipment, net	(5,728)	(23,407)
Purchase of marketable securities	(84,567)	(153,441)
Proceeds from maturities of marketable securities	68,658	101,181
Restricted cash	285	300
Other assets	11	41
Net cash used in investing activities	<u>(21,341)</u>	<u>(75,326)</u>
Cash flows from financing activities:		
Proceeds from issuance of common stock, net	82,850	7,950
Repayment of notes receivable from stockholders	2,058	661
Repurchase of common stock	(200)	—
Proceeds from issuance of bank line of credit	1,000	—
Repayment of notes payable and bank line of credit	(2,500)	—
Net cash provided by financing activities	<u>83,208</u>	<u>8,611</u>
Effect of exchange rate changes on cash and cash equivalents	24	(8)
Net increase (decrease) in cash and cash equivalents	68,775	(50,079)
Cash and cash equivalents, beginning of the period	26,786	116,305
Cash and cash equivalents, end of the period	<u>\$ 95,561</u>	<u>\$ 66,226</u>
Supplemental disclosure of significant non-cash investing activities:		
Purchases of property and equipment through accounts payable	\$ —	\$ 7,692

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

FORMFACTOR, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 1 — Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of FormFactor, Inc. and its subsidiaries (the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission. Accordingly, the interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 25, 2004 are not necessarily indicative of the results that may be expected for the year ending December 25, 2004, or for any other period. The balance sheet at December 27, 2003 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. These financial statements and notes should be read with the financial statements and notes thereto for the year ended December 27, 2003 included in the Company's Annual Report on Form 10-K for the year ended December 27, 2003, as amended, filed with the Securities and Exchange Commission.

Note 2 — Inventories

Inventories are stated at the lower of cost (principally standard cost which approximates actual cost on a first-in, first-out basis) or market value. Reserves for potentially excess and obsolete inventory are made based on inventory levels and future sales forecasts.

Inventories, net of reserves, consisted of the following (in thousands):

	December 27, 2003	September 25, 2004
Raw materials	\$3,128	\$ 4,079
Work-in-progress	4,628	5,845
Finished goods	269	126
	<u>\$8,025</u>	<u>\$10,050</u>

Note 3 — Warranty

The Company offers warranties on certain products and records a liability for the estimated future costs associated with customer claims, which is based upon historical experience and the Company's estimate of the level of future costs. Warranty costs are reflected in the income statement as a cost of revenues. A reconciliation of the changes in the Company's warranty liability is as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Beginning balance	\$ 536	\$ 494	\$ 679	\$ 446
Reserve for warranties issued during the period	198	180	663	606
Settlements made during the period	(198)	(180)	(806)	(558)
Ending balance	<u>\$ 536</u>	<u>\$ 494</u>	<u>\$ 536</u>	<u>\$ 494</u>

FORMFACTOR, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

Note 4 — Stock-Based Compensation

The Company uses the intrinsic value method of Accounting Principles Board Opinion No. 25 (“APB No. 25”), “Accounting for Stock Issued to Employees,” in accounting for its employee stock options, and presents disclosure of the pro forma information required under SFAS No. 123 (“SFAS No. 123”), “Accounting for Stock-Based Compensation” as amended by SFAS No. 148, “Accounting for Stock-Based Compensation — Transition and Disclosure.” The Company uses the Black-Scholes option pricing model to compute its pro forma net income and pro forma earnings per share.

Had compensation cost for the Company’s stock option grants, Employee Stock Purchase Plan to employees been determined based on the fair values of the stock option at the date of grant consistent with the provisions of SFAS No. 123, the Company’s net income would have been changed to the pro-forma amounts as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Net income available to common stockholders, as reported	\$ 2,241	\$ 7,497	\$ 1,186	\$19,356
Add: Stock-based employee compensation expense included in reported net income, net of tax	494	371	1,447	1,238
Deduct: Total stock-based employee compensation expense determined under minimum or fair value based method (as applicable) for all awards, net of tax	(1,628)	(1,767)	(3,222)	(4,832)
Pro forma net income (loss) available to common stockholders	<u>\$ 1,107</u>	<u>\$ 6,101</u>	<u>\$ (589)</u>	<u>\$15,762</u>
Net income (loss) per share basic:				
As reported	<u>\$ 0.07</u>	<u>\$ 0.20</u>	<u>\$ 0.07</u>	<u>\$ 0.52</u>
Pro forma	<u>\$ 0.03</u>	<u>\$ 0.16</u>	<u>\$ (0.04)</u>	<u>\$ 0.42</u>
Diluted:				
As reported	<u>\$ 0.06</u>	<u>\$ 0.19</u>	<u>\$ 0.04</u>	<u>\$ 0.48</u>
Pro forma	<u>\$ 0.03</u>	<u>\$ 0.15</u>	<u>\$ (0.04)</u>	<u>\$ 0.39</u>

(1) Due to adoption of EITF 03-06 which requires allocation of income to certain holders of equity and debt instruments (see Note 9).

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The Company has adopted the disclosure only provisions of SFAS No. 123. Prior to the Company's initial public offering in June 2003, the Company calculated the fair value of each option on the date of grant using the minimum value method as prescribed by SFAS No. 123. Therefore, the pro forma net income and pro forma net income per share may not be representative for future periods. The weighted-average assumptions used are as follows:

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Stock Options				
Dividend yield	—	—	—	—
Risk-free interest rate	3.37%	3.50%	2.99%	3.46%
Expected life (in years)	5	5	5	5
Expected volatility	67%	50%	67%	46%
ESPP				
Dividend yield	—	—	—	—
Risk-free interest rate	1.52%	1.64%	1.52%	1.64%
Expected life (in years)	0.5	0.5	0.5	0.5
Expected volatility	67%	58%	67%	58%

The weighted-average per share grant date fair value of options granted during the three and nine months ended September 27, 2003 was \$11.31 and \$8.07, and was \$9.04, and \$8.88 for the three and nine months ended September 25, 2004, respectively. The weighted-average per share estimated fair value of purchase rights granted under the 2002 Employee Stock Purchase Plan was \$7.74 for the three and nine months ended September 25, 2004.

Note 5 — Net Income per Share

Basic net income per share is computed by dividing net income by the weighted-average number of common shares outstanding for the period. Diluted net income per share is computed giving effect to all potential dilutive common stock, including options, warrants, common stock subject to repurchase and redeemable convertible preferred stock.

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

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Numerator:				
Net income	\$ 2,241	\$ 7,497	\$ 3,696	\$19,356
Preferred stock dividend(1)	—	—	(2,510)	—
Net income available to common stockholders	<u>\$ 2,241</u>	<u>\$ 7,497</u>	<u>\$ 1,186</u>	<u>\$19,356</u>
Denominator:				
Weighted-average common stock outstanding	34,284	37,769	16,800	37,691
Less:				
Weighted-average shares subject to repurchase	<u>(167)</u>	<u>(137)</u>	<u>(171)</u>	<u>(107)</u>

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	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Weighted-average shares used in computing net income per share	34,117	37,632	16,629	37,584
Dilutive potential common shares used in computing diluted net income per share	3,927	2,867	16,504	2,906
Total weighted-average number of shares used in computing diluted net income per share	38,044	40,499	33,133	40,490

(1) Due to adoption of EITF 03-06 which requires allocation of income to certain holders of equity and debt instruments (see Note 9).

The following outstanding options to purchase common stock were excluded from the computation of diluted net income per share as they had an antidilutive effect (in thousands):

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Options to purchase common stock	15	1,414	1,362	454

Note 6 — Commitments and Contingencies

From time to time, the Company may be subject to legal proceedings and claims in the ordinary course of business. As of the filing date of this quarterly report, the Company was not involved in any material legal proceedings, other than as set forth below.

On February 24, 2004, the Company filed in the Seoul Southern District Court, located in Seoul, South Korea, two separate complaints against Phicom Corporation, a Korean corporation, alleging infringement of a total of four Korean patents issued to the Company. Both of the Complaints seek injunctive relief. The court actions are a part of the Company's ongoing efforts to protect the intellectual property embodied in its proprietary technology, including its MicroSpring interconnect technology. In March 2004, Phicom filed in the Korean Intellectual Property Office invalidity actions challenging the validity of some or all of the claims of each of the Company's four Korean patents at issue.

FORMFACTOR, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited) — (Continued)

The Company from time to time in the ordinary course of its business enters into contractual arrangements with third parties under which the Company has agreed to defend, indemnify and hold the third party harmless from and against certain losses. These arrangements may limit the time within which an indemnification claim can be made, the type of the claim and the total amount that the Company can be required to pay in connection with the indemnification obligation. In addition, the Company has entered into indemnification agreements with its directors and officers, and the Company's bylaws contain indemnification obligations in favor of the Company's directors, officers and agents. It is not possible to determine or reasonably estimate the maximum potential amount of future payments under these indemnification obligations due to the varying terms of such obligations, the history of prior indemnification claims and the unique facts and circumstances involved in each particular contractual arrangement and in each potential future claim for indemnification. The Company has not had any claims for indemnification under these arrangements, nor has it had a history of indemnifying third parties. The Company has not recorded any liabilities for these indemnification arrangements in the Company's condensed consolidated balance sheet as of September 25, 2004.

In September 2004, the Company determined that it was entitled to receive a refund of certain taxes paid related to its business in Japan. The refund relates to approximately \$1.0 million in consumption tax paid during fiscal 2003. The Company anticipates receiving this refund within the next fiscal quarter. This gain contingency will be recognized in other income when the funds are received.

Note 7 — Stockholders' Equity

Comprehensive Income (Loss)

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

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

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Net income	\$2,241	\$7,497	\$3,696	\$19,356
Change in unrealized gain (loss) on marketable securities, net of tax	—	307	—	(232)
Foreign currency translation adjustments	(27)	(15)	(18)	(39)
Comprehensive income	<u>\$2,214</u>	<u>\$7,789</u>	<u>\$3,678</u>	<u>\$19,085</u>

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

	December 27, 2003	September 25, 2004
Unrealized gain on marketable securities, net of tax	\$ 47	\$(184)
Cumulative translation adjustments	(51)	(90)
Accumulated other comprehensive loss	<u>\$ (4)</u>	<u>\$(274)</u>

Note 8 — Derivative Financial Instruments

The Company purchases forward exchange contracts to hedge certain existing foreign currency denominated accounts receivable. These hedges do not qualify for hedge accounting treatment per the provisions of Statement of Financial Accounting Standards No. 133, "Accounting for Derivative Instruments and Hedging Activities." The Company recognizes gains or losses from the fluctuation in foreign exchange rates and the valuation of these hedge contracts in other expense. The Company does not use derivative financial instruments for trading or speculative purposes.

FORMFACTOR, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

As of September 25, 2004, the Company had five forward exchange contracts outstanding, allowing the Company to sell 1.0 billion Yen for \$8.7 million with contract rates ranging from 108.30 Yen to 110.66 Yen per U.S. dollar. The estimated fair value for these contracts was \$8.6 million as of September 25, 2004. These contracts are due between October 2004 and January 2005.

Note 9 — Recent Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (“EITF”) reached a consensus on recognition and measurement guidance previously discussed under EITF Issue No. 03-01, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.” (“EITF 03-01”). The consensus clarifies the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” and investments accounted for under the cost method. This consensus is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. The adoption of EITF 03-1 did not have a material impact on the Company’s consolidated result of operations.

In April 2004, the EITF issued Statement No. 03-06 “Participating Securities and the Two Class Method” under FAS Statement 128 “Earnings per Share”. EITF Statement No. 03-06 addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. It requires that undistributed earnings for the period be allocated to a participating security based on the contractual participation rights of the security to share in those earnings as if all the earnings for the period had been distributed in calculating earnings per share. EITF Statement No. 03-06 is effective for fiscal periods beginning after March 15, 2004. It requires that prior period earnings per share amounts be restated to ensure comparability period over period. Net income available to common stockholders and net income per share for the nine months ended September 27, 2003 has been restated in accordance with EITF 03-06 as a portion of the net income for this period was allocable to the redeemable convertible preferred stock in accordance with the dividend rights. All of the redeemable convertible preferred stock was converted to common stock in connection with the Company’s IPO in June 2003. Accordingly, there was no impact on EPS for the three months ended September 27, 2003 or the three and nine months ended September 25, 2004.

Note 10 — Subsequent Events:

On October 5, 2004, the Company signed an eight-year lease for an additional 12,000 square feet of research and development space. The Company will invest in certain leasehold improvements to the facility to allow for the completion of a dedicated research and development line. The aggregate lease commitment for the lease term will be approximately \$1.4 million and cost to construct the necessary leasehold improvements will be approximately \$3.3 million.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Statement Regarding Forward-Looking Statements

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

The forward-looking statements are only predictions based on our current expectations and our projections about future events. All forward-looking statements included in this quarterly report are based upon information available to us as of the filing date of this quarterly report. You should not place undue reliance on these forward-looking statements. We undertake no obligation to update any of these statements for any reason. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from those expressed or implied by these statements. These factors include the matters discussed in the section titled “Risks That May Affect Future Results” and elsewhere in this quarterly report. You should carefully consider the numerous risks and uncertainties described under “Risks That May Affect Future Results.”

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and the accompanying notes contained in this quarterly report. Unless expressly stated or the context otherwise requires, the terms “we,” “our,” “us,” “the Company,” and “FormFactor” refer to FormFactor, Inc. and its subsidiaries.

Overview

We design, develop, manufacture, sell and support precision, high performance advanced semiconductor wafer probe cards. The semiconductor industry has historically been cyclical and is characterized by wide fluctuations in product supply and demand. Semiconductor manufacturers use our wafer probe cards to perform wafer probe test on the whole semiconductor wafer in the front end of the semiconductor manufacturing process. After the fabrication of a semiconductor wafer, the chips on the wafer are subject to wafer probe test. During wafer probe test, a wafer probe card is mounted in a prober, which is in turn connected to a semiconductor tester, and the wafer probe card is used as an interface to electrically connect with and test individual chips on a wafer. At the core of our product offering is our proprietary technology including our MicroSpring interconnect technology and proprietary design processes. Our MicroSpring interconnect technology includes a resilient contact element manufactured at our production facilities in Livermore, California. To date, we have derived our revenues primarily from the sale of wafer probe cards incorporating our MicroSpring interconnect technology.

We work closely with our customers to design, develop and manufacture custom wafer probe cards. Each wafer probe card is a custom product that is specific to the chip and wafer designs of the customer. As a result, our revenue growth is driven by the number of new semiconductor designs, technology transitions and increased semiconductor production volumes.

Revenues. Wafer probe card sales comprise substantially all of our revenues. Increases in revenues have resulted from increased demand for our existing products, the introduction of new, more complex products and the penetration of new markets. Revenues from our customers are subject to both quarterly and annual fluctuations due to a number of issues, including design cycles, technology adoption rates and cyclicity of the different end markets into which our customers’ products are sold. We expect that revenues from the sale of wafer probe cards will continue to account for substantially all of our revenues for the foreseeable future.

Cost of Revenues. Cost of revenues consists primarily of manufacturing materials, payroll and manufacturing-related overhead. In addition, cost of revenues also includes costs related to the start up of our new manufacturing facility. Our manufacturing operations rely upon a limited number of suppliers to provide key components and materials for our products, some of which are sole source. We order materials and supplies based on backlog and non-binding forecasted customer orders. Tooling and setup costs related to changing manufacturing lots at our suppliers are also included in the cost of revenues. We expense all warranty costs and inventory reserves or write-offs as cost of revenues. We design, manufacture and sell a custom product into a market that has been subject to cyclicity and significant demand fluctuations. Wafer probe cards are complex products, custom to a specific chip design and have to be delivered on lead-times shorter than most manufacturers’ cycle times. It is therefore common to start production and to acquire

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production materials ahead of the receipt of an actual purchase order. Wafer probe cards are manufactured in low volumes, therefore, material purchases are often subject to minimum purchase order quantities in excess of our actual demand. Inventory valuation adjustments for these factors are considered a normal component of cost of revenues.

Research and Development. Research and development expenses include expenses related to product development, engineering and material costs. All research and development costs are expensed as incurred. We plan to invest a significant amount in research and development activities to develop new technologies for current and new markets and new applications in the future.

Selling, General and Administrative. Selling, general and administrative expenses include expenses related to sales, marketing, and administrative personnel, internal and outside sales representatives' commissions, market research and consulting, and other marketing, sales and administrative activities. We expect that selling expenses will increase as revenues increase, and we expect that general and administrative expenses will increase in absolute dollars to support future revenue growth, as well as from the additional costs of being a publicly traded company.

Stock-Based Compensation. In connection with the grant of stock options to employees in fiscal 2001 and fiscal 2002, and in fiscal 2003 through our initial public offering in June 2003, we recorded an aggregate of \$14.3 million in deferred stock-based compensation. These options are considered compensatory because the fair value of our stock determined for financial reporting purposes is greater than the fair value determined on the date of the grant. As of September 25, 2004, we had an aggregate of \$5.3 million of deferred stock-based compensation remaining to be amortized. This deferred stock-based compensation balance will be amortized as follows: \$747,000 during the remainder of fiscal 2004; \$2.6 million during fiscal 2005; \$1.5 million during fiscal 2006; and \$532,000 during fiscal 2007. We are amortizing the deferred stock-based compensation on a straight line basis from the date of grant through the vesting period of the related options, which is generally four to five years. For options granted to employees to date, the amount of stock-based compensation amortization to be recognized in future periods could decrease if options for which deferred but unvested compensation has been recorded are forfeited. Stock-based compensation expenses have been classified to the income statement expense category consistent with the category where related employee expenses are classified.

Use of Estimates. Our discussion and analysis of our financial condition and results of operations are based upon our unaudited condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to uncollectible receivables, inventories, marketable securities, intangible assets, income taxes, warranty obligations, excess component and order cancellation costs, and contingencies and litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources.

Results of Operations

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

	Three Months Ended		Nine Months Ended	
	September 27, 2003	September 25, 2004	September 27, 2003	September 25, 2004
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of revenues	50.7	49.6	51.6	48.4
Stock-based compensation	0.6	0.3	0.7	0.4
Gross margin	48.7	50.1	47.7	51.2
Operating expenses:				
Research and development	15.2	10.8	16.9	11.0
Selling, general and administrative	19.1	15.4	20.2	15.7
Stock-based compensation	2.5	0.9	2.8	1.2
Total operating expenses	36.8	27.1	39.9	27.9
Operating income	11.9	23.0	7.8	23.3
Interest income	1.1	1.2	0.9	1.3
Interest expense	(0.0)	(0.0)	(0.1)	0.0
Other income (expense), net	0.9	(0.3)	0.3	(0.6)
	2.0	0.9	1.1	0.7
Income before income taxes	13.9	23.9	8.9	24.0
Provision for income taxes	(5.2)	(9.4)	(3.4)	(9.5)
Net income	8.7	14.5	5.5	14.5
Preferred stock dividend	0.0	0.0	(3.8)	0.0
Net income available to common stockholders	8.7%	14.5%	1.7%	14.5%

Three Months Ended September 25, 2004 and September 27, 2003

Revenues. Revenues for the three months ended September 25, 2004 were \$51.4 million compared with \$26.1 million for the three months ended September 27, 2003, an increase of \$25.3 million, or 97%. The \$25.3 million increase was due primarily to an increase of \$20.6 million in revenues from DRAM manufacturers, an increase of \$5.7 million from manufacturers of flash memory devices, an increase of \$612,000 in other revenues offset by a decrease of \$1.6 million in revenues from manufacturers of flip chip devices. Revenues continued to grow across all regions as conventional probe cards continue to be replaced by advanced wafer test technologies. The build out of 300mm wafer production capacity brought additional demand for wafer probe cards as part of our customers overall capacity expansion. New applications like mobile RAM as well as design wins in Flash memory further contributed to the overall growth in revenues.

The majority of revenues for the three months ended September 25, 2004 was generated by sales of wafer probe cards to manufacturers of DRAM devices. Sales of wafer probe cards to test DRAM devices accounted for \$34.6 million, or 67.3% of revenues, for the quarter ended September 25, 2004 compared to \$14.0 million, or 53.8% of revenues, for the quarter ended September 27, 2003. The increase was primarily due to a general increase in customer ship production volume as well as the continued execution of major DRAM transitions to 110 and sub 110 nanometer technology, 512 megabit density, 300mm capacity ramps, DDR II architecture and mobile RAM applications.

Revenues generated from sales to flash memory device manufacturers increased from \$7.0 million for the quarter ended September 27, 2003 to \$12.7 million for the quarter ended September 25, 2004. The increase was driven by strong demand for high parallelism flash memory test products as well as continued ramp in 300mm capacity.

Revenues from manufacturers of flip chip logic devices decreased to \$3.4 million for the three months ended September 25, 2004 from \$5.0 million for the three months ended September 27, 2003 due to design and mix shift at our customers as well as our continued capacity constraints during 2004.

Revenues by geographic region for the three months ended September 25, 2004 as a percentage of revenues were 32.9% in North America, 19.4% in Europe, 21.6% in Japan and 26.1% in Asia Pacific. Revenues by geographic region for the three months ended September 27, 2003 as a percentage of revenues were 52.3% in North America, 6.1% in Europe, 22.5% in Japan and 19.1% in Asia Pacific. For the three months ended September 25, 2004, revenues in absolute dollars for all geographic regions increased due to strong demand for our wafer probe cards.

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The following customers accounted for more than 10% of our revenues for the three months ended September 27, 2003 or September 25, 2004:

	Three Months Ended	
	September 27, 2003	September 25, 2004
Intel Corporation	38.0%	12.4%
Elpida	12.3	15.4
Spirox Corporation	16.4	20.9
Infineon Technologies AG	*	16.3

* Less than 10% of revenues.

Revenues to Intel Corporation for the three months ended September 25, 2004 decreased to 12.9% of revenues compared to 38.0% for the three months ended September 27, 2003. The decrease was mainly due to the decline in logic business as well as our strong growth in revenues from other semiconductor device manufacturers.

Gross Margin. Gross margin as a percentage of revenues was 50.1% for the three months ended September 25, 2004 compared with 48.7% for the three months ended September 27, 2003. The increase in gross margin percentage was primarily due to increased revenues, gains in manufacturing efficiencies and product mix, offset by \$1.2 million of non-recurring expenses related to the start up of our new manufacturing facility.

Research and Development. Research and development expenses increased to \$5.6 million, or 10.8% of revenues, for the three months ended September 25, 2004 compared to \$4.0 million, or 15.2% of revenues, for the three months ended September 27, 2003. The increase in absolute dollars was mainly due to an increase of approximately \$1.0 million in personnel costs and an increase of approximately \$380,000 in development program materials and related costs. Through the three month period ended September 25, 2004, we continued the development of our next generation parallelism product, fine pitch memory and logic products, advanced MicroSpring interconnect technology and new process technologies. We are currently building a dedicated research and development line as part of our new site project, as we believe it is critical to continue to make significant investments in research and development.

Selling, General and Administrative. Selling, general and administrative expenses were \$7.9 million for the three months ended September 25, 2004, or 15.4% of revenues, compared to \$5.0 million, or 19.1% of revenues, for the three months ended September 27, 2003. The increase in absolute dollars was mainly due to an increase of approximately \$1.0 million in personnel related expenses, an increase of \$354,000 in commissions to our sales representatives driven by the increase in revenues and an increase of \$1.1 million in outside professional services mainly related to patent litigation as well as increased compliance related expenses.

Interest and Other Income (Expense), Net. Interest and other income (expense), for the three months ended September 25, 2004 was \$479,000 compared with \$520,000 for the three months ended September 27, 2003. We generated greater interest income in the third quarter of 2004 resulting from a larger cash, cash equivalents and marketable securities balance throughout the quarter as a result of the completion of our initial public offering and follow-on public offering in 2003, partially offset by approximately \$97,000 in foreign currency losses.

Provision for Income Taxes. Provision for income taxes was \$4.8 million for the three months ended September 25, 2004 compared with \$1.4 million for the three months ended September 27, 2003. The \$4.8 million provision for the third quarter of 2004 reflected an effective tax rate of 39.1% compared with an effective tax rate of 38.4% for the third quarter of 2003. The increase in the effective tax rate was primarily caused by the expiration of the U.S. tax legislation for research and development credits on June 30, 2004. This tax legislation was reinstated on October 4, 2004, extending the expiration date of the research and development tax credit retroactively from June 30, 2004 through December 31, 2005.

Nine Months Ended September 25, 2004 and September 27, 2003

Revenues. Revenues for the nine months ended September 25, 2004 were \$131.6 million compared with \$66.8 million for the nine months ended September 27, 2003, an increase of \$64.8 million, or 97.0%. The \$64.8 million increase was due primarily to an increase of \$52.1 million in revenues from DRAM manufacturers, an increase of \$13.5 million from manufacturers of flash memory

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devices, an increase of \$1.2 million in other revenues, offset by a decrease of \$2.0 million in revenues from manufacturers of flip chip logic devices.

The majority of revenues for the nine months ended September 25, 2004 was generated by sales of wafer probe cards to manufacturers of DRAM devices. Sales of wafer probe cards to test DRAM devices accounted for \$90.9 million, or 69.0% of revenues, for the nine months ended September 25, 2004 compared to \$38.8 million, or 58.0% of revenues, for the nine months ended September 27, 2003. The increase was primarily due to a general increase in customer ship production volume as well as the continued execution of major DRAM transitions to 110 and sub 110 nanometer technology, 512 megabit density, 300mm capacity ramps, DDR II architecture and mobile RAM applications.

Revenues generated from sales to flash memory device manufacturers increased from \$14.1 million for the nine months ended September 27, 2003 to \$27.6 million for the nine months ended September 25, 2004. The increase was driven by strong demand for high parallelism flash memory test products, the ramp of new customers and design wins achieved in the first nine months of 2004.

Revenues from manufacturers of flip chip logic devices decreased to \$11.5 million for the nine months ended September 25, 2004 from \$13.5 million for the nine months ended September 27, 2003 due to design and mix shift at our customers as well as our continued capacity constraints during 2004.

Revenues by geographic region for the nine months ended September 25, 2004 as a percentage of revenues were 38.4% in North America, 13.3% in Europe, 27.9% in Japan and 20.4% in Asia Pacific. Revenues by geographic region for the nine months ended September 27, 2003 as a percentage of revenues were 56.5% in North America, 9.1% in Europe, 15.7% in Japan and 18.7% in Asia Pacific. For the nine months ended September 25, 2004, revenues for all geographic regions in absolute dollars increased due to strong demand for our wafer probe cards.

The following customers accounted for more than 10% of our revenues for the nine months ended September 27, 2003 or September 25, 2004:

	Nine Months Ended	
	September 27, 2003	September 25, 2004
Intel Corporation	34.6%	14.9%
Elpida	*	20.7
Samsung	10.8	*
Spirox Corporation	15.1	17.2
Infineon Technologies AG	*	11.2

* Less than 10% of revenues.

Revenues to Intel Corporation for the nine months ended September 25, 2004 decreased to 14.9% of revenues compared to 34.6% for the nine months ended September 27, 2003. The decrease was mainly due to the decline in logic business as well as our strong growth in revenues from other semiconductor device manufacturers. Revenues to Elpida increased to 20.7% of revenues for the nine months ended September 25, 2004 due to the factory ramp at this customer.

Gross Margin. Gross margin as a percentage of revenues was 51.2% for the nine months ended September 25, 2004 compared with 47.7% for the nine months ended September 27, 2003. The increase in gross margin percentage was primarily due to increased revenues, gains in manufacturing efficiencies and product mix, offset by \$2.0 million of non-recurring expenses related to the start up of our new manufacturing facility.

Research and Development. Research and development expenses increased to \$14.4 million, or 11.0% of revenues, for the nine months ended September 25, 2004 compared to \$11.3 million, or 16.9% of revenues, for the nine months ended September 27, 2003. The increase in absolute dollars was mainly due to an increase of approximately \$1.8 million in personnel costs and an increase of approximately \$962,000 in development program materials and related costs. Through the nine month period ended September 25, 2004, we continued the development of our next generation parallelism product, fine pitch memory and logic products, advanced MicroSpring interconnect technology and new process technologies. We are currently building a dedicated research and development line as part of our new site project, as we believe it is critical to continue to make significant investments in research and development.

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Selling, General and Administrative. Selling, general and administrative expenses were \$20.6 million for the nine months ended September 25, 2004, or 15.7% of revenues, compared to \$13.5 million, or 20.2% of revenues, for the nine months ended September 27, 2003. The increase in absolute dollars was mainly due to an increase of approximately \$3.4 million in personnel related expenses, an increase of \$432,000 in commissions to our sales representatives driven by the increase in revenues and an increase in outside professional services of \$2.0 million mainly related to patent litigation as well as increased compliance related expenses.

Interest and Other Income (Expense), Net. Interest and other income (expense), for the nine months ended September 25, 2004 was \$942,000 compared with \$780,000 for the nine months ended September 27, 2003. We generated greater interest income in the first nine months of 2004 resulting from a larger cash, cash equivalents and marketable securities balance throughout the period as a result of our initial public offering and follow-on public offering in 2003, partially offset by approximately \$597,000 in foreign currency losses.

Provision for Income Taxes. Provision for income taxes was \$12.5 million for the nine months ended September 25, 2004 compared with \$2.3 million for the nine months ended September 27, 2003. The \$12.5 million provision for the first nine months of 2004 reflected an effective tax rate of 39.2% compared with an effective tax rate of 38.4% for the first nine months of 2003. The increase in the effective tax rate was primarily caused by the expiration of the U.S. tax legislation for research and development credits on June 30, 2004. This tax legislation was reinstated on October 4, 2004, extending the expiration date of the research and development tax credit retroactively from June 30, 2004 through December 31, 2005.

Critical Accounting Policies and Estimates

For a description of the critical accounting policies that affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements, refer to our Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission. There have been no changes to our critical accounting policies since September 25, 2004.

Liquidity and Capital Resources

As of September 25, 2004, we had \$183.5 million in cash, cash equivalents, marketable securities and restricted cash, compared with \$181.8 million as of December 27, 2003.

Net cash provided by operating activities was \$16.6 million for the nine months ended September 25, 2004 compared with \$6.9 million for the nine months ended September 27, 2003. Net cash provided by operating activities for the nine months ended September 25, 2004 resulted primarily from an increase in net income and accrued liabilities partially offset by an increase in accounts receivable and inventories.

Accounts receivable increased by \$13.9 million for the nine months ended September 25, 2004 due to an increase in worldwide sales and specifically due to an increase in sales in Japan, where we typically experience longer payment terms. For the nine months ended September 25, 2004, net inventories increased by \$2.0 million due to an increase in raw materials and work-in-process to support revenue growth. Accrued liabilities increased by \$5.0 million for the nine month period ended September 25, 2004 due primarily to an increase in accrued income taxes as well as accrued employee incentive compensation including a profit sharing plan for non-executive employees implemented in the third quarter of 2004.

Net cash used in investing activities was \$75.3 million for the nine months ended September 25, 2004, compared to net cash used in investing activities of \$21.3 million for the nine months ended September 27, 2003. Net cash used in investing activities resulted primarily from the purchase of marketable securities or maturity of marketable securities in each of these periods. Capital expenditures were \$23.4 million for the nine months ended September 25, 2004 and \$5.7 million for the nine months ended September 27, 2003. The increase in capital expenditures was due primarily to the investment in our new manufacturing facility.

Net cash provided by financing activities was \$8.6 million for the nine months ended September 25, 2004 compared with \$83.2 million for the nine months ended September 27, 2003. Net cash provided by financing activities for the first nine months of 2004 was primarily due to the issuance of common stock upon exercises of stock options. Net cash provided by financing activities for the first nine months of 2003 was primarily due to the issuance of common stock in our initial public offering.

In May 2001, we signed a ten-year lease for 119,000 square feet of manufacturing, research and development and office space. The total remaining rent obligation over the term of the lease is \$22.5 million and is accounted for as an operating lease. We expect to invest approximately \$3.5 to \$4.0 million in leasehold improvements for our new headquarters and manufacturing facility through the second quarter of 2005.

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The following table describes our commitments to settle contractual obligations in cash as of September 25, 2004.

	Payments Due by Fiscal Year				Total
	2004	2005-2006	2007-2008	After 2008	
				(In thousands)	
Operating leases	\$950	\$5,567	\$5,404	\$10,583	\$22,504

On October 5, 2004 we signed an eight-year lease for an additional 12,000 square feet of research and development space. We will invest in certain leasehold improvements to the facility to allow for the completion of a dedicated research and development line. The aggregate lease commitment for the lease term will be approximately \$1.4 million and cost to construct the necessary leasehold improvements will be approximately \$3.3 million.

We believe that cash generated from operations, together with the liquidity provided by our existing cash, cash equivalents and marketable securities will be sufficient to meet our anticipated cash needs for at least the next 12 months. Our future capital requirements will depend on many factors, including our rate of revenue growth, the timing and extent of spending to support product development efforts, the expansion of sales and marketing activities, our research and development initiatives, the timing and introductions of new products and enhancements to existing products, the costs to ensure access to adequate manufacturing capacity, including the completion of our new manufacturing facility, research and development pilot line, and the continuing market acceptance of our products.

Off-Balance Sheet Arrangements

As part of our ongoing business, we do not participate in transactions that generate relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, or SPEs, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 25, 2004, we were not involved in any unconsolidated SPE transactions.

Recent Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (“EITF”) reached a consensus on recognition and measurement guidance previously discussed under EITF Issue No. 03-01, “The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.” (“EITF 03-01”). The consensus clarifies the meaning of other-than-temporary impairment and its application to investments in debt and equity securities, in particular investments within the scope of FASB Statement No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” and investments accounted for under the cost method. This consensus is to be applied to other-than-temporary impairment evaluations in reporting periods beginning after June 15, 2004. The adoption of EITF 03-1 did not have a material impact on our consolidated results of operations.

In April 2004, the Emerging Issues Task Force (EITF) issued Statement No. 03-06 “Participating Securities and the Two Class Method” under FAS Statement 128 “Earnings per Share”. EITF Statement No. 03-06 addresses a number of questions regarding the computation of earnings per share by companies that have issued securities other than common stock that contractually entitle the holder to participate in dividends and earnings of the company when, and if, it declares dividends on its common stock. It requires that undistributed earnings for the period be allocated to a participating security based on the contractual participation rights of the security to share in those earnings as if all the earnings for the period had been distributed in calculating earnings per share. EITF Statement No. 03-06 is effective for fiscal periods beginning after March 15, 2004. It requires that prior period earnings per share amounts be restated to ensure comparability period over period. Net income available to common stockholders and net income per share for the nine months ended September 27, 2003 has been restated in accordance with EITF 03-06 as a portion of the net income for this period was allocable to the redeemable convertible preferred stock in accordance with the dividend rights. All of the redeemable convertible preferred stock was converted to common stock in connection with our initial public offering in June 2003. Accordingly, there was no impact on EPS for the three months ended September 27, 2003 or the three and nine months ended September 25, 2004.

Risks That May Affect Future Results

You should carefully consider the following risk factors, as well as the other information in this quarterly report on Form 10-Q, in evaluating FormFactor and our business. If any of the following risks actually occur, our business, financial condition and results of operations would suffer. In this case, the trading price of our common stock would likely decline and you might lose all or part of your investment in our common stock. The risks described below are not the only ones we face. Additional risks that we currently do not know about or that we currently believe to be immaterial may also impair our business operations.

Our operating results are likely to fluctuate, which could cause us to miss expectations about these results and cause the trading price of our common stock to decline.

Our operating results are likely to fluctuate. Some of the important factors that could cause our revenues and operating results to fluctuate from period-to-period include:

- customer demand for our products;
- our ability to deliver reliable, cost-effective products in a timely manner;
- the reduction, rescheduling or cancellation of orders by our customers;
- the timing and success of new product introductions and new technologies by our competitors and us;
- our product and customer sales mix and geographical sales mix;
- changes in the level of our operating expenses needed to support our anticipated growth;

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- a reduction in the price or the profitability of our products;
- changes in our production capacity or the availability or the cost of components and materials;
- our ability to transition efficiently and effectively to our new production facility;
- our ability to bring new products into volume production efficiently;
- the timing of and return on our investments in research and development;
- our ability to collect accounts receivable;
- seasonality, principally due to our customers' purchasing cycles; and
- market conditions in our industry, the semiconductor industry and the economy as a whole.

The occurrence of one or more of these factors might cause our operating results to vary widely. As a result, we believe that you should not rely on period-to-period comparisons of our financial results as an indication of our future performance. If our revenues or operating results fall below the expectations of market analysts or investors, the market price of our common stock could decline substantially.

Cyclical in the semiconductor industry historically has affected our sales and might do so in the future, and as a result we could experience reduced revenues or operating results.

The semiconductor industry has historically been cyclical and is characterized by wide fluctuations in product supply and demand. From time to time, this industry has experienced significant downturns, often in connection with, or in anticipation of, maturing product and technology cycles, excess inventories and declines in general economic conditions. This cyclical nature could cause our operating results to decline dramatically from one period to the next. For example, our revenues in the three months ended March 29, 2003 declined by 15.7% compared to our revenues in the three months ended December 28, 2002. Our business depends heavily upon the development of new semiconductors and semiconductor designs, the volume of production by semiconductor manufacturers and the overall financial strength of our customers, which, in turn, depend upon the current and anticipated market demand for semiconductors and products, such as personal computers and consumer electronics, that use semiconductors. If we are unable to adjust our levels of manufacturing and human resources or manage our costs and deliveries from suppliers in response to lower spending by semiconductor manufacturers, our gross margin might decline and cause us to experience decreased operating results or operating losses.

If we do not keep pace with technological developments in the semiconductor industry, our products might not be competitive and our revenues and operating results could suffer.

We must continue to invest in research and development to improve our competitive position and to meet the needs of our customers. Our future growth depends, in significant part, upon our ability to work effectively with and anticipate the testing needs of our customers, and on our ability to develop and support new products and product enhancements to meet these needs on a timely and cost-effective basis. Our customers' testing needs are becoming more challenging as the semiconductor industry continues to experience rapid technological change driven by the demand for complex circuits that are shrinking in size and at the same time are increasing in speed and functionality and becoming less expensive to produce. Examples of recent trends driving demand for technological research and development include semiconductor manufacturers' transitions to 110 nanometer and sub 110 nanometer technology nodes, to 512 megabit density devices and to Double Data Rate II, or DDR II, architecture devices. Our customers expect that they will be able to integrate our wafer probe cards into any manufacturing process as soon as it is deployed. Therefore, to meet these expectations and remain competitive, we must continually design, develop and introduce on a timely basis new products and product enhancements with improved features. Successful product design, development and introduction on a timely basis require that we:

- design innovative and performance-enhancing features that differentiate our products from those of our competitors;
- transition our products to new manufacturing technologies;

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- identify emerging technological trends in our target markets;
- maintain effective marketing strategies;
- respond effectively to technological changes or product announcements by others; and
- adjust to changing market conditions quickly and cost-effectively.

We must devote significant research and development resources to keep up with the rapidly evolving technologies used in semiconductor manufacturing processes. Not only do we need the technical expertise to implement the changes necessary to keep our technologies current, but we must also rely heavily on the judgment of our management to anticipate future market trends. If we are unable to timely predict industry changes, or if we are unable to modify our products on a timely basis, we might lose customers or market share. In addition, we might not be able to recover our research and development expenditures, which could harm our operating results.

If semiconductor memory device manufacturers delay, cancel and/or postpone the conversion to 300 mm wafers, our growth could be impeded.

The growth of our business for the foreseeable future depends in large part upon sales of our wafer probe cards to manufacturers of dynamic random access memory, or DRAM, and flash memory devices. The previous downturn in the semiconductor industry caused various chip manufacturers to readdress their respective strategies for converting existing 200 mm wafer fabrication facilities to 300 mm wafer fabrication, or for building new 300 mm wafer fabrication facilities. We believe that the decision to convert to a 300 mm wafer fabrication facility is made by each manufacturer based upon both internal and external factors, which could include considerations such as:

- current and projected chip prices;
- projected price erosion for the manufacturer's particular chips;
- supply and demand issues;
- overall manufacturing capability within the manufacturer's target market(s);
- the availability of funds to the manufacturer;
- the technology roadmap of the manufacturer; and
- the price and availability of equipment needed within the 300 mm facility.

One or more of these internal and external factors, as well as other factors, including factors that a manufacturer may choose to not publicly disclose, can impact the decision to maintain a 300 mm conversion schedule, to delay the conversion schedule for a period of time, or to cancel the conversion. It is also possible that the conversion to 300 mm wafers will occur on different schedules for DRAM chip manufacturers and flash memory chip manufacturers. We have invested significant resources to develop technology that addresses the market for 300 mm wafers. If manufacturers of memory devices delay or discontinue the transition to 300 mm wafers, or make the transition more slowly than we currently expect, our growth and profitability could be impeded. In addition, any delay in large-scale adoption of manufacturing based upon 300 mm wafers would provide time for other companies to develop and market products that compete with ours, which could harm our competitive position.

We are subject to general economic and market conditions.

Our business is subject to the effects of general economic conditions in the United States and worldwide, and to market conditions in the semiconductor industry in particular. For example, in fiscal 2001, our operating results were adversely affected by unfavorable global economic conditions and reduced capital spending by semiconductor manufacturers. These adverse conditions resulted in a decrease in the demand for semiconductors and products using semiconductors, and in a sharp reduction in the development of new semiconductors and semiconductor designs. As a result, we experienced a decrease in the demand for our wafer probe cards. If such conditions occur again or other events occur that adversely impact general economic and market conditions, we could experience material negative effects on our business.

We depend upon the sale of our wafer probe cards for substantially all of our revenues, and a downturn in demand for our products could have a more disproportionate impact on our revenues than if we derived revenues from a more diversified product offering.

Historically, we have derived substantially all of our revenues from the sale of our wafer probe cards. We anticipate that sales of our wafer probe cards will represent a substantial majority of our revenues for the foreseeable future. Our business depends in large part upon continued demand in current markets for, and adoption in new markets of, current and future generations of our wafer probe cards. Large-scale market adoption depends upon our ability to increase customer awareness of the benefits of our wafer probe cards and to prove their reliability, ability to increase yields and cost effectiveness. We may be unable to sell our wafer probe cards to certain potential customers unless those customers change their device test strategies, change their wafer probe card and capital equipment buying strategies, or change or upgrade their existing test equipment. We might not be able to sustain or increase our revenues from sales of our wafer probe cards, particularly if conditions in the semiconductor market deteriorate or if the market enters into another downturn in the future. Any decrease in revenues from sales of our wafer probe cards could harm our business more than it would if we offered a more diversified line of products.

If demand for our products in the memory device and flip chip logic markets declines or fails to grow as we anticipate, our revenues could decline.

We derive substantially all of our revenues from wafer probe cards that we sell to manufacturers of DRAM memory and flash memory devices and manufacturers of microprocessor, chipset and other logic devices. In the microprocessor, chipset and other logic device markets, our products are primarily used for devices employing flip chip packaging, which devices are commonly referred to as flip chip logic devices. In the three and nine months ended September 25, 2004, sales to manufacturers of DRAM devices accounted for 67.3% and 69.0%, respectively, of our revenues, sales to manufacturers of flip chip logic devices accounted for 6.6% and 8.7%, respectively, of our revenues, and sales to manufacturers of flash memory devices accounted for 24.7% and 21%, respectively, of our revenues. For fiscal 2003, sales to manufacturers of DRAM devices accounted for 61.3% of our revenues, sales to manufacturers of flip chip logic devices accounted for 19.1% of our revenues, and sales to manufacturers of flash memory devices accounted for 18.4% of our revenues. Our success depends in part upon the continued acceptance of our products within these markets and our ability to continue to develop and introduce new products on a timely basis for these markets. For example, the market might not accept an increasingly high parallelism wafer test solution.

A substantial portion of these semiconductor devices is sold to manufacturers of personal computers and computer-related products. The personal computer market has historically been characterized by significant fluctuations in demand and continuous efforts to reduce costs, which in turn have affected the demand for and price of DRAM devices and microprocessors. The personal computer market might not grow in the future at historical rates or at all and design activity in the personal computer market might decrease, which could negatively affect our revenues and operating results.

The markets in which we participate are intensely competitive, and if we do not compete effectively, our operating results could be harmed.

The wafer probe card market is highly competitive. With the introduction of new technologies and market entrants, we expect competition to intensify in the future. In the past, increased competition has resulted in price reductions, reduced gross margins or loss of market share, and could do so in the future. Competitors might introduce new competitive products for the same markets that our products currently serve. These products may have better performance, lower prices and broader acceptance than our products. In addition, for products such as wafer probe cards, semiconductor manufacturers typically qualify more than one source, to avoid dependence on a single source of supply. As a result, our customers will likely purchase products from our competitors. Current and potential competitors include Advantest Corporation, AMST Co., Ltd., Cascade Microtech, Inc., ESJ Corporation, Feinmetall GmbH, Japan Electronic Materials Corporation, Kulicke and Soffa Industries, Inc., Micronics Japan Co., Ltd., MicroProbe, Inc., NanoNexus Inc., Phicom Corporation, SCS Hightech, Inc., Tokyo Cathode Laboratory Co., Ltd., Tokyo Electron Ltd. and Wentworth Laboratories, Inc., among others. Many of our current and potential competitors have greater name recognition, larger customer bases, more established customer relationships or greater financial, technical, manufacturing, marketing and other resources than we do. As a result, they might be able to respond more quickly to new or emerging technologies and changes in customer requirements, devote greater resources to the development, promotion, sale and support of their products, and reduce prices to increase market share. Some of our competitors also supply other types of test equipment, or offer both advanced wafer probe cards and needle probe cards. Those competitors that offer both advanced wafer probe cards and needle probe cards might have strong, existing relationships with our customers or with potential customers. Because we do not offer a needle probe card or other conventional technology wafer probe card for less advanced applications, it may be difficult for us to introduce our advanced wafer probe cards to these customers and potential customers for certain wafer test applications. It is possible that existing or new competitors, including test equipment manufacturers, may offer new technologies that reduce the value of our wafer probe cards.

We derive a substantial portion of our revenues from a small number of customers, and our revenues could decline significantly if any major customer cancels, reduces or delays a purchase of our products.

A relatively small number of customers accounts for a significant portion of our revenues in any particular period. In the three and nine months ended September 25, 2004, four customers accounted for 65% and 64%, respectively, of our revenues. In fiscal 2003, four customers accounted for 66.2% of our revenues. Our ten largest customers accounted for 93.9% and 94.7%, respectively, of our revenues in the three and nine months ended September 25, 2004, and 94.8% of our revenues in fiscal 2003. We anticipate that sales of our products to a relatively small number of customers will continue to account for a significant portion of our revenues. The cancellation or deferral of even a small number of purchases of our products could cause our revenues to decline in any particular quarter. A number of factors could cause customers to cancel or defer orders, including manufacturing delays, interruptions to our customers' operations due to fire, natural disasters or other events or a downturn in the semiconductor industry. Our agreements with our customers do not contain minimum purchase commitments, and our customers could cease purchasing our products with short or no notice to us or fail to pay all or part of an invoice. In some situations, our customers might be able to cancel orders without a significant penalty. In addition, the continuing trend toward consolidation in the semiconductor industry, particularly among manufacturers of DRAMs, could reduce our customer base and lead to lost or delayed sales and reduced demand for our wafer probe cards. Industry consolidation also could result in pricing pressures as larger DRAM manufacturers could have sufficient bargaining power to demand reduced prices and favorable nonstandard terms. Additionally, certain customers may not want to rely entirely or substantially on a single wafer probe card supplier and, as a result, such customers could reduce their purchases of our wafer probe cards.

If our relationships with our customers and other companies that manufacture semiconductor test equipment deteriorate, our product development activities could be harmed.

The success of our product development efforts depends upon our ability to anticipate market trends and to collaborate closely with our customers and with other companies that manufacture semiconductor test equipment. Our relationships with these customers and companies provide us with access to valuable information regarding manufacturing and process technology trends in the semiconductor industry, which enables us to better plan our product development activities. These relationships also provide us with opportunities to understand the performance and functionality requirements of our customers, which improve our ability to customize our products to fulfill their needs. Our relationships with test equipment companies are important to us because test equipment companies can design our wafer probe cards into their equipment and provide us with the insight into their product plans that allows us to offer wafer probe cards for use with their products when they are introduced to the market. Our relationships with our customers and test equipment companies could deteriorate if they:

- become concerned about our ability to protect their intellectual property;
- develop their own solutions to address the need for testing improvement;
- regard us as a competitor;
- establish relationships with others in our industry; or
- attempt to restrict our ability to enter into relationships with their competitors.

Many of our customers and the test equipment companies we work with are large companies. The consequences of a deterioration in our relationship with any of these companies could be exacerbated due to the significant influence these companies can exert in our markets. If our current relationships with our customers and test equipment companies deteriorate, or if we are unable to develop similar collaborative relationships with important customers and test equipment companies in the future, our long-term ability to produce commercially successful products could be impaired.

Because we generally do not have a sufficient backlog of unfilled orders to meet our quarterly revenue targets, revenues in any quarter are substantially dependent upon customer orders received and fulfilled in that quarter.

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Our revenues are difficult to forecast because we generally do not have a sufficient backlog of unfilled orders to meet our quarterly revenue targets at the beginning of a quarter. Rather, a majority of our revenues in any quarter depends upon customer orders for our wafer probe cards that we receive and fulfill in that quarter. Because our expense levels are based in part on our expectations as to future revenues and to a large extent are fixed in the short term, we might be unable to adjust spending in time to compensate for any unexpected shortfall in revenues. Accordingly, any significant shortfall of revenues in relation to our expectations could hurt our operating results.

We rely upon a distributor for a substantial portion of our revenues, and a disruption in our relationship with our distributor could have a negative impact on our revenues.

We rely on Spirox Corporation, our distributor in Taiwan, Singapore and China, for a substantial portion of our revenues. Sales to Spirox accounted for 20.9% and 17.2%, respectively, of our revenues in the three and nine months ended September 25, 2004 and 13.4% of our revenues in fiscal 2003. Spirox also provides customer support. A reduction in the sales or service efforts or financial viability of our distributor, or deterioration in, or termination of, our relationship with our distributor could harm our revenues, our operating results and our ability to support our customers in the distributor's territory. In addition, establishing alternative sales channels in the region could consume substantial time and resources, decrease our revenues and increase our expenses.

If our relationships with our independent sales representatives change, our business could be harmed.

We currently rely on independent sales representatives to assist us in the sale of our products in various geographic regions. If we make the business decision to terminate or modify our relationships with one or more of our independent sales representatives, or if an independent sales representative decides to disengage from us, and we do not effectively and efficiently manage such a change, we could lose sales to existing customers and fail to obtain new customers.

If semiconductor manufacturers do not migrate elements of final test to wafer probe test, or implement our wafer-level known good die testing or burn-in solutions, our revenues could be negatively impacted and the market acceptance of other applications of our technology could be delayed.

We intend to work with our customers to migrate elements of final test from the device level to the wafer level. This migration will involve a change in semiconductor test strategies from concentrating final test at the individual device level to increasing the amount of test at the wafer level. We are also engaging with certain of our customers to implement at the wafer-level known good die, or KGD, testing and burn-in. Semiconductor manufacturers typically take time to qualify new strategies that affect their testing operations. As a result, general acceptance of wafer-level final test, or of our wafer-level KGD testing or burn-in solutions, might not occur in the near term or at all. In addition, semiconductor manufacturers might not accept and use wafer-level final test in a way that uses our technology, or may implement a different KGD testing or burn-in solution. If the migration of elements of final test to wafer probe test, or of the implementation of wafer-level KGD testing or burn-in, does not grow as we anticipate, or if semiconductor manufacturers do not adopt our technology for their wafer probe test requirements, market acceptance of other applications for our technology could be delayed.

Changes in test strategies, equipment and processes could cause us to lose revenues.

The demand for wafer probe cards depends in large part upon the number of semiconductor designs and the overall semiconductor unit volume. The time it takes to test a wafer depends upon the number of devices being tested, the complexity of these devices, the test software program and the test equipment itself. As test programs become increasingly effective and test throughput increases, the number of wafer probe cards required to test a given volume of devices declines. Therefore, advances in the test process could cause us to lose sales.

If semiconductor manufacturers implement chip designs that include increased built-in self-test capabilities, or similar functions or methodologies that increase test throughput, it could negatively impact our sales or the migration of elements of final test to the wafer level. Additionally, if new chip designs or types of chips are implemented that require less, or even no, test using wafer probe cards, our revenues could be impacted. Further, if new chip designs are implemented which we are unable to test, or which we are unable to test efficiently and provide our customers with an acceptably low overall cost of test, our revenues could be negatively impacted.

We incur significant research and development expenses in conjunction with the introduction of new product platforms. Because our customers use our wafer probe cards with test equipment manufactured by third parties, if we time one of our product introductions to the introduction of a new test equipment platform manufactured by a third party, any delay or disruption of the introduction of the new test equipment platforms would negatively affect our growth.

We manufacture all of our products at a single facility, and any disruption in the operations of that facility could adversely impact our business and operating results.

Our processes for manufacturing our wafer probe cards require sophisticated and costly equipment and a specially designed facility, including a semiconductor clean room. While we are commencing the move to our new manufacturing facility we currently manufacture our wafer probe cards at one facility located in Livermore, California. Any disruption in the operation of that facility, whether due to technical or labor difficulties, destruction or damage from fire or earthquake, infrastructure failures such as power or water shortage or any other reason, could interrupt our manufacturing operations, impair critical systems, disrupt communications with our customers and suppliers and cause us to write off inventory and to lose sales. In addition, if the recent energy crises in California that resulted in disruptions in power supply and increases in utility costs were to recur, we might experience power interruptions and shortages, which could disrupt our manufacturing operations. This could subject us to loss of revenues as well as significantly higher costs of energy. Further, current and potential customers might not purchase our products if they perceive our lack of an alternate manufacturing facility to be a risk to their continuing source of supply.

If we do not transition effectively to our new operations and manufacturing site, our manufacturing capacity will be negatively impacted.

We have completed the construction of our new manufacturing facility in Livermore and commenced to move our manufacturing operations into the new facility. The costs of starting up our new manufacturing facility, including capital costs such as equipment and fixed costs such as rent, will be substantial. We might not be able to shift from our current production facility to the new production facility efficiently or effectively. The transition will require us to have both our existing and new manufacturing facilities operational for several quarters, including into 2005. This will cause us to incur significant costs due to redundancy of infrastructure and the need to employ operations teams at both sites. Furthermore, the qualification of the new manufacturing facility by us and by our customers will require us to use materials and build product and product components that will not be sold to our customers, causing higher than normal material spending. The transition might also lead to manufacturing interruptions, which could mean delayed deliveries or lost sales. Some or all of our customers could require a full qualification of our new facility. Any qualification process could take longer than we anticipate. Any difficulties with the transition or with bringing the new manufacturing facility to full capacity and volume production could increase our costs, disrupt our production process and cause delays in product delivery and lost sales, which would harm our operating results.

If we are unable to manufacture our products efficiently, our operating results could suffer.

We must continuously modify our manufacturing processes in an effort to improve yields and product performance, lower our costs and reduce the time it takes us to design and produce our products. We will incur significant start-up costs associated with implementing new manufacturing technologies, methods and processes and purchasing new equipment, which could negatively impact our gross margin. We could experience manufacturing delays and inefficiencies as we refine new manufacturing technologies, methods and processes, implement them in volume production and qualify them with customers, which could cause our operating results to decline. The risk of encountering delays or difficulties increases as we manufacture more complex products. In addition, if demand for our products increases, we will need to expand our operations to manufacture sufficient quantities of products without increasing our production times or our unit costs. As a result of such expansion, we could be required to purchase new equipment, upgrade existing equipment, develop and implement new manufacturing processes and hire additional technical personnel. Further, new or expanded manufacturing facilities could be subject to qualification by our customers. In the past, we have experienced difficulties in expanding our operations to manufacture our products in volume on time and at acceptable cost. Any difficulties in expanding our manufacturing operations could cause product delivery delays and lost sales. If demand for our products decreases, we could have excess manufacturing capacity. The fixed costs associated with excess manufacturing capacity could cause our operating results to decline. If we are unable to achieve further manufacturing efficiencies and cost reductions, particularly if we are experiencing pricing pressures in the marketplace, our operating results could suffer.

If we are unable to continue to reduce the time it takes for us to design and produce a wafer probe card, our growth could be impeded.

Our customers continuously seek to reduce the time it takes them to introduce new products to market. The cyclical nature of the semiconductor industry, coupled with changing demands for semiconductor devices, requires our customers to be flexible and highly adaptable to changes in the volume and mix of products they must produce. Each of those changes requires a new design and each new design requires a new wafer probe card. For some existing semiconductor devices, the manufacturers' volume and mix of product requirements are such that we are unable to design, manufacture and ship products to meet such manufacturers' relatively short cycle

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time requirements. If we are unable to reduce the time it takes for us to design, manufacture and ship our products in response to the needs of our customers, our competitive position could be harmed. If we are unable to meet a customer's schedule for wafer probe cards for a particular design, our customer might purchase wafer probe cards from a competitor and we might lose sales.

We obtain some of the components and materials we use in our products from a single or sole source or a limited group of suppliers, and the partial or complete loss of one of these suppliers could cause production delays and a substantial loss of revenues.

We obtain some of the components and materials used in our products, such as printed circuit board assemblies, plating materials and ceramic substrates, from a single or sole source or a limited group of suppliers. Alternative sources are not currently available for sole source components and materials. Because we rely on purchase orders rather than long-term contracts with the majority of our suppliers, we cannot predict with certainty our ability to obtain components and materials in the longer term. A sole or limited source supplier could increase prices, which could lead to a decline in our gross margin. Our dependence upon sole or limited source suppliers exposes us to several other risks, including a potential inability to obtain an adequate supply of materials, late deliveries and poor component quality. Disruption or termination of the supply of components or materials could delay shipments of our products, damage our customer relationships and reduce our revenues. For example, if we are unable to obtain an adequate supply of a component or material, we might have to use a substitute component or material, which could require us to make changes in our manufacturing process. From time to time in the past, we have experienced difficulties in receiving shipments from one or more of our suppliers, especially during periods of high demand for our products. If we cannot obtain an adequate supply of the components and materials we require, or do not receive them in a timely manner, we might be required to identify new suppliers. We might not be able to identify new suppliers on a timely basis or at all. Our customers and we would also need to qualify any new suppliers. The lead-time required to identify and qualify new suppliers could affect our ability to timely ship our products and cause our operating results to suffer. Further, a sole or limited source supplier could require us to enter into non-cancelable purchase commitments or pay in advance to ensure our source of supply. In an industry downturn, commitments of this type could result in charges for excess inventory of parts. If we are unable to predict our component and materials needs accurately, or if our supply is disrupted, we might miss market opportunities by not being able to meet the demand for our products.

Wafer probe cards that do not meet specifications or that contain defects could damage our reputation, decrease market acceptance of our technology, cause us to lose customers and revenues, and result in liability to us.

The complexity and ongoing development of our wafer probe card manufacturing process, combined with increases in wafer probe card production volumes, have in the past and could in the future lead to design or manufacturing problems. For example, the presence of contaminants in our plating baths has caused a decrease in our manufacturing yields or has resulted in unanticipated stress-related failures when our wafer probe cards are being used in the manufacturing test environment. Manufacturing design errors such as the miswiring of a wafer probe card or the incorrect placement of probe contact elements have caused us to repeat manufacturing design steps. In addition to these examples, problems might result from a number of factors, including design defects, materials failures, contamination in the manufacturing environment, impurities in the materials used, unknown sensitivities to process conditions, such as temperature and humidity, and equipment failures. As a result, our products have in the past contained and might in the future contain undetected errors or defects. Any errors or defects could:

- cause lower than anticipated yields and lengthening of delivery schedules;
- cause delays in product shipments;
- cause delays in new product introductions;
- cause us to incur warranty expenses;
- result in increased costs and diversion of development resources;
- cause us to incur increased charges due to unusable inventory;
- require design modifications; or
- decrease market acceptance or customer satisfaction with these products.

The occurrence of any one or more of these events could hurt our operating results.

In addition, if any of our products fails to meet specifications or has reliability, quality or compatibility problems, our reputation could be damaged significantly and customers might be reluctant to buy our products, which could result in a decline in revenues, an increase in product returns or warranty costs and the loss of existing customers or the failure to attract new customers. Our customers use our products with test equipment and software in their manufacturing facilities. Our products must be compatible with the customers' equipment and software to form an integrated system. If the system does not function properly, we could be required to provide field application engineers to locate the problem, which can take time and resources. If the problem relates to our wafer probe cards, we might have to invest significant capital, manufacturing capacity and other resources to correct it. Our current or potential customers also might seek to recover from us any losses resulting from defects or failures in our products. Liability claims could require us to spend significant time and money in litigation or to pay significant damages.

If we fail to forecast demand for our products accurately, we could incur inventory losses.

Each semiconductor chip design requires a custom wafer probe card. Because our products are design-specific, demand for our products is difficult to forecast. Due to our customers' short delivery time requirements, we often design, and at times produce, our products in anticipation of demand for our products rather than in response to an order. Due to the uncertainty inherent in forecasts, we are and expect to continue to be subject to inventory risk. If we do not obtain orders as we anticipate, we could have excess inventory for a specific customer design that we would not be able to sell to any other customer, which would likely result in inventory write-offs.

If we fail to effectively manage our regional service centers, our business might be harmed.

In 2002, we opened a regional repair and service center in Seoul, South Korea, in 2003, we opened a regional repair and service center in Dresden, Germany, and in July 2004 we opened a regional repair and service center in Tokyo, Japan. These regional service centers are part of our strategy to, among other things, provide our customers with more efficient service and repair of our wafer probe cards. If we are unable to effectively manage our regional service centers, or if the work undertaken in the regional service centers is not equivalent to the level and quality provided by repairs and services performed by our North American repair and service operations, which are part of our manufacturing facility in Livermore, California, we could incur higher wafer probe card repair and service costs, which could harm our operating results.

If we do not effectively manage changes in our business, these changes could place a significant strain on our management and operations and, as a result, our business might not succeed.

Our ability to grow successfully requires an effective planning and management process. We plan to increase the scope of our operations and the size of our direct sales force domestically and internationally. For example, we have leased a new facility in Livermore, California and are completing the building improvements and have commenced moving our corporate headquarters and manufacturing operations into this facility in 2004. Our growth could place a significant strain on our management systems, infrastructure and other resources. To manage our growth effectively, we must invest the necessary capital and continue to improve and expand our systems and infrastructure in a timely and efficient manner. Those resources might not be available when we need them, which would limit our growth. Our officers have limited experience in managing large or rapidly growing businesses. In addition, our management has limited experience in managing a public company or communicating with securities analysts and public company investors. Our controls, systems and procedures might not be adequate to support a growing public company. If our management fails to respond effectively to changes in our business, our business might not succeed.

If we fail to attract, integrate and retain qualified personnel, our business might be harmed.

Our future success depends largely upon the continued service of our key management, technical, and sales and marketing personnel, and on our continued ability to hire, integrate and retain qualified individuals. For example, we are presently engaged in a search for our next chief financial officer who will succeed Jens Meyerhoff, our chief operating officer and current chief financial officer. In addition, we may need additional engineers and sales and marketing personnel in order to increase market awareness of our products and to increase revenues and in the future, we might need technical personnel experienced in competencies that we do not currently have or require. Competition for qualified individuals may be intense, and we might not be successful in retaining our employees or attracting new personnel. The loss of any key employee, the inability to successfully integrate replacement personnel, including our next chief financial officer, the failure of any key employee to perform in his or her current position or our inability to attract and retain skilled employees as needed could impair our ability to meet customer and technological demands. All of our key

personnel in the United States are employees at-will. We have no employment contracts with any of our personnel in the United States.

We may make acquisitions, which could put a strain on our resources, cause ownership dilution to our stockholders and adversely affect our financial results.

While we have made no acquisitions of businesses, products or technologies in the past, we may make acquisitions of complementary businesses, products or technologies in the future. Integrating newly acquired businesses, products or technologies into our company could put a strain on our resources, could be expensive and time consuming, and might not be successful. Future acquisitions could divert our management's attention from other business concerns and expose our business to unforeseen liabilities or risks associated with entering new markets. In addition, we might lose key employees while integrating new organizations. Consequently, we might not be successful in integrating any acquired businesses, products or technologies, and might not achieve anticipated revenues and cost benefits. In addition, future acquisitions could result in customer dissatisfaction, performance problems with an acquired company, potentially dilutive issuances of equity securities or the incurrence of debt, contingent liabilities, possible impairment charges related to goodwill or other intangible assets or other unanticipated events or circumstances, any of which could harm our business.

As part of our sales process, we could incur substantial sales and engineering expenses that do not result in revenues, which would harm our operating results.

Our customers generally expend significant efforts evaluating and qualifying our products prior to placing an order. The time that our customers require to evaluate and qualify our wafer probe cards is typically between three and 12 months and sometimes longer. While our customers are evaluating our products, we might incur substantial sales, marketing, and research and development expenses. For example, we typically expend significant resources educating our prospective customers regarding the uses and benefits of our wafer probe cards and developing wafer probe cards customized to the potential customer's needs, for which we might not be reimbursed. Although we commit substantial resources to our sales efforts, we might never receive any revenues from a customer. For example, many semiconductor designs never reach production, including designs for which we have expended design effort and expense. In addition, prospective customers might decide not to use our wafer probe cards. The length of time that it takes for the evaluation process and for us to make a sale depends upon many factors including:

- the efforts of our sales force and our distributor and independent sales representatives;
- the complexity of the customer's fabrication processes;
- the internal technical capabilities of the customer; and
- the customer's budgetary constraints and, in particular, the customer's ability to devote resources to the evaluation process.

In addition, product purchases are frequently subject to delays, particularly with respect to large customers for which our products may represent a small percentage of their overall purchases. As a result, our sales cycles are unpredictable. If we incur substantial sales and engineering expenses without generating revenues, our operating results could be harmed.

From time to time, we might be subject to claims of infringement of other parties' proprietary rights, or to claims that our intellectual property rights are invalid or unenforceable, which could result in significant expense and loss of intellectual property rights.

In the future, we might receive claims that we are infringing intellectual property rights of others, or claims that our patents or other intellectual property rights are invalid or unenforceable. We have received in the past, and may receive in the future, communications from third parties inquiring about our interest in licensing certain of their intellectual property or more generally identifying intellectual property that may be of interest to us. For example, we received such a communication from Microelectronics and Computer Technology Corporation in October 2001, with a follow-up letter in January 2002, inquiring about our interest in acquiring a license to certain of their patents and technology, and from IBM Corporation in February 2002, with a follow-up letter in August 2003, inquiring about our interest and need to acquire a license to IBM patents and technology related to high density integrated probes. We have not engaged in a dialog with Microelectronics and Computer Technology Corporation. We have engaged in a dialog with IBM regarding our companies' respective intellectual property portfolios and technologies, and is continuing this dialog. In August 2002, subsequent to our initiating correspondence with Japan Electronic Materials Corporation

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regarding the scope of our intellectual property rights and the potential applicability of those rights to certain of its wafer probe cards, Japan Electronic Materials Corporation offered that precedent technologies exist as to one of our foreign patents that we had identified, and also referenced a U.S. patent in which it stated we might take interest. For the inquiries we have received to date, we do not believe we infringe any of the identified patents and technology. The semiconductor industry is characterized by uncertain and conflicting intellectual property claims and vigorous protection and pursuit of these rights. The resolution of any claims of this nature, with or without merit, could be time consuming, result in costly litigation or cause product shipment delays. In the event of an adverse ruling, we might be required to pay substantial damages, cease the use or sale of infringing products, spend significant resources to develop non-infringing technology, discontinue the use of certain technology or enter into license agreements. License agreements, if required, might not be available on terms acceptable to us or at all. The loss of access to any of our intellectual property or the ability to use any of our technology could harm our business.

If we fail to protect our proprietary rights, our competitors might gain access to our technology, which could adversely affect our ability to compete successfully in our markets and harm our operating results.

If we fail to protect our proprietary rights adequately, our competitors might gain access to our technology. Unauthorized parties might attempt to copy aspects of our products or to obtain and use information that we regard as proprietary. Others might independently develop similar or competing technologies or methods or design around our patents. In addition, the laws of many foreign countries in which we or our customers do business do not protect our intellectual property rights to the same extent as the laws of the United States. As a result, our competitors might offer similar products and we might not be able to compete successfully. We also cannot assure that:

- our means of protecting our proprietary rights will be adequate;
- patents will be issued from our currently pending or future applications;
- our existing patents or any new patents will be sufficient in scope or strength to provide any meaningful protection or commercial advantage to us;
- any patent, trademark or other intellectual property right that we own will not be invalidated, circumvented or challenged in the United States or foreign countries; or
- others will not misappropriate our proprietary technologies or independently develop similar technology, duplicate our products or design around any patent or other intellectual property rights that we own.

We might be required to spend significant resources to monitor and protect our intellectual property rights. We presently believe that it is likely that one or more of our competitors are using methodologies or have implemented structures into certain of their products that are covered by one or more of our intellectual property rights. On February 24, 2004, we filed in the Seoul Southern District Court, located in Seoul, South Korea, two separate complaints against Phicom Corporation, a Korean corporation, alleging infringement of a total of four Korean patents issued to FormFactor. One Complaint alleges that Phicom is infringing our Korean Patent Nos. 252,457, entitled "Method of Fabricating Interconnections Using Cantilever Elements and Sacrificial Substrates," and 324,064, entitled "Contact Tip Structures for Microelectronic Interconnection Elements and Methods of Making Same." The other Complaint alleges Phicom is infringing our Korean Patent Nos. 278,342, entitled "Method of Altering the Orientation of Probe Elements in a Probe Card Assembly," and 399,210, entitled "Probe Card Assembly." Both of the Complaints seek injunctive relief. The court actions are a part of our ongoing efforts to protect the intellectual property embodied in our proprietary technology, including our MicroSpring interconnect technology. In March 2004, Phicom filed in the Korean Intellectual Property Office invalidity actions challenging the validity of some or all of the claims of each of our four Korean patents at issue. On October 6, 2004, Micronics Japan Co., Ltd. filed in the Korean Intellectual Property Office an invalidity action challenging the validity of our Korean Patent No. 312872. We could incur material expenses in these litigations and proceedings. We may initiate other claims or litigation against Phicom or other third parties for infringement of our proprietary rights or to establish the validity of our proprietary rights. If we threaten or initiate litigation, we may be subject to claims by third parties against which we must defend. Any litigation, whether or not it is resolved in our favor, could result in significant expense to us and divert the efforts of our technical and management personnel. In addition, many of our customer contracts contain provisions that require us to indemnify our customers for third party intellectual property infringement claims, which would increase the cost to us of an adverse ruling in such a claim. An adverse determination could also prevent us from licensing our technologies and methods to others.

Our failure to comply with environmental laws and regulations could subject us to significant fines and liabilities, and new laws and regulations or changes in regulatory interpretation or enforcement could make compliance more difficult and costly.

We are subject to various and frequently changing U.S. federal, state and local, and foreign governmental laws and regulations relating to the protection of the environment, including those governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes, the cleanup of contaminated sites and the maintenance of a safe workplace. We could incur substantial costs, including cleanup costs, civil or criminal fines or sanctions and third-party claims for property damage or personal injury, as a result of violations of or liabilities under environmental laws and regulations or non-compliance with the environmental permits required at our facilities.

For instance, in February 2004, a contractor at our manufacturing facility discharged certain diesel fuel mixed with water into a storm drain. We notified the appropriate agencies, assisted in their investigation and in the activities of a third party to assist with the cleanup activities. We have not yet been notified as to whether any financial penalties will be imposed based upon the incident and, if imposed, whether such penalties would be significant. It is possible that in the future, we may receive environmental violation notices, and that final resolution of the violations identified by these notices could harm our operating results.

These laws, regulations and permits also could require the installation of costly pollution control equipment or operational changes to limit pollution emissions or decrease the likelihood of accidental releases of hazardous substances. In addition, new laws and regulations, stricter enforcement of existing laws and regulations, the discovery of previously unknown contamination at our or others' sites or the imposition of new cleanup requirements could require us to curtail our operations, restrict our future expansion, subject us to liability and cause us to incur future costs that would have a negative effect on our operating results and cash flow.

Because we conduct some of our business internationally, we are subject to operational, economic, financial and political risks abroad.

Sales of our products to customers outside the United States have accounted for an important part of our revenues. Our international sales as a percentage of our revenues were 67.1% and 61.6%, respectively, for the three and nine months ended September 25, 2004. In the future, we expect international sales, particularly into Europe, Japan, South Korea and Taiwan, to continue to account for a significant percentage of our revenues. Accordingly, we will be subject to risks and challenges that we would not otherwise face if we conducted our business only in the United States. These risks and challenges include:

- compliance with a wide variety of foreign laws and regulations;
- legal uncertainties regarding taxes, tariffs, quotas, export controls, export licenses and other trade barriers;
- political and economic instability in, or foreign conflicts that involve or affect, the countries of our customers;
- difficulties in collecting accounts receivable and longer accounts receivable payment cycles;
- difficulties in staffing and managing personnel, distributors and representatives;
- reduced protection for intellectual property rights in some countries;
- currency exchange rate fluctuations, which could affect the value of our assets denominated in local currency, as well as the price of our products relative to locally produced products;
- seasonal fluctuations in purchasing patterns in other countries; and
- fluctuations in freight rates and transportation disruptions.

Any of these factors could harm our existing international operations and business or impair our ability to continue expanding into international markets.

We might require additional capital to support business growth, and such capital might not be available.

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We intend to continue to make investments to support business growth and may require additional funds to respond to business challenges, which include the need to develop new products or enhance existing products, enhance our operating infrastructure and acquire complementary businesses and technologies. Accordingly, we may need to engage in equity or debt financing to secure additional funds. Equity and debt financing, however, might not be available when needed or, if available, might not be available on terms satisfactory to us. If we are unable to obtain adequate financing or financing on terms satisfactory to us, our ability to continue to support our business growth and to respond to business challenges could be significantly limited.

Failure or circumvention of our controls and procedures could seriously harm our business.

We are evaluating our disclosure controls and procedures and our internal control over financial reporting on an ongoing basis. For example, we are undertaking a thorough review of our internal controls in connection with our preparation for compliance with Section 404 of the Sarbanes-Oxley Act of 2002. We believe that our controls and procedures, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. The design of any control system is based, in part, upon the benefits of the control system relative to its costs. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote. A failure to achieve such stated goals could seriously harm our business.

Our reported financial results may be adversely affected by changes in accounting principles generally accepted in the United States.

We prepare our financial statements in conformity with accounting principles generally accepted in the United States. These accounting principles are subject to interpretation by the Financial Accounting Standards Board, the American Institute of Certified Public Accountants, the Securities and Exchange Commission and various bodies formed to interpret and create appropriate accounting principles. A change in these principles or interpretations could have a significant effect on our reported financial results, and could affect the reporting of transactions completed before the announcement of a change.

Recently enacted and proposed changes in securities laws and regulations are likely to increase our costs and may impact our competitiveness in a global market environment.

The Sarbanes-Oxley Act of 2002, as well as new rules and regulations subsequently implemented by the Securities and Exchange Commission, have required changes to some of our corporate governance practices. The Act also requires the Securities and Exchange Commission to promulgate additional new rules on a variety of subjects. In addition to final rules and rule proposals already made by the Securities and Exchange Commission, Nasdaq has adopted revisions to its requirements for companies, such as us, that are Nasdaq-listed. We expect these new rules and regulations to increase our legal and financial compliance costs, as certain foreign competing companies have no such cost, and to make some activities more difficult, time consuming and/or costly and to make it more difficult and more expensive for us to obtain director and officer liability insurance. These new rules and regulations could also make it more difficult for us to attract and retain qualified members of our board of directors, particularly to serve on our audit committee, and qualified executive officers.

If we fail to timely complete the evaluation of our internal controls as required under Section 404 of the Sarbanes-Oxley Act, or if we complete our evaluation but not in time to permit our independent registered public accountants to timely complete their attestation procedures for our controls, the reliability of our internal controls over financial reporting may be impacted and we cannot predict how the market or regulators will react.

Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal controls, and an attestation of the effectiveness of these controls by our independent registered public accountants. We are currently documenting and testing our controls and considering whether any improvements are necessary for maintaining an effective control environment at our company. This process has caused us to incur, and we expect to continue to incur, substantial costs and efforts, which could adversely affect our results of operations. We may encounter problems or delays in completing our review and evaluation. If any deficiencies in our control environment are identified, we may not have sufficient time to implement improvements to our controls or new controls to address such deficiencies. In addition, we may not complete our evaluation of our internal controls in time to permit our independent registered public accountants to timely complete their assessment of our internal controls and/or we may not receive a positive attestation from them. In particular, our independent registered public accountants have advised us that they believe that there is a significant risk that we may not be able to complete the assessment of our controls associated with our information technology systems in a time frame that permits them to timely complete their attestation of our controls. This could, in turn, impact our ability to comply with applicable SEC rules and regulations relating to the filing of our financial statements and have an adverse effect on the trading price of our stock as we cannot predict how the market or regulators will react.

Unanticipated changes in our tax rates or exposure to additional income tax liabilities could affect our profitability.

We are subject to income taxes in both the United States and various foreign jurisdictions, and our domestic and international tax liabilities are subject to the allocation of expenses in different jurisdictions. Our effective tax rate could be adversely affected by changes in the mix of earnings in countries with different statutory tax rates, changes in the valuation of deferred tax assets and liabilities, changes in tax laws including pending tax law changes, such as the benefit from export sales and the research and development credit by material audit assessments. In particular, the carrying value of deferred tax assets, which are predominantly in the United States, is dependent on our ability to generate future taxable income in the United States. In addition, the amount of income taxes we pay could be subject to ongoing audits in various jurisdictions and a material assessment by a governing tax authority could affect our profitability.

The trading price of our common stock is likely to be volatile, and you might not be able to sell your shares at or above the price that you paid for them.

The trading prices of the securities of technology companies have been highly volatile. Accordingly, the trading price of our common stock is likely to be subject to wide fluctuations. Further, our securities have a limited trading history. Factors affecting the trading price of our common stock include:

- variations in our operating results;
- our ability or perceived ability to transition efficiently and effectively to our new production facility;
- announcements of technological innovations, new products or product enhancements, strategic alliances or significant agreements by us or by our competitors;
- recruitment or departure of key personnel;
- the gain or loss of significant orders or customers;
- actual or perceived constraints in our ability to supply customer orders;
- changes in the estimates of our operating results or changes in recommendations by any securities analysts that elect to follow our common stock;
- sales or perceived sales of substantial amounts of our common stock held by existing stockholders, including our directors and executive officers; and
- market conditions in our industry, the industries of our customers and the economy as a whole.

In addition, if the market for technology stocks or the stock market in general experiences continued or greater loss of investor confidence, the trading price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. The trading price of our common stock also might decline in reaction to events that affect other companies in our industry even if these events do not directly affect us.

If securities analysts do not publish research or reports about our business or downgrade our stock, our stock price could decline.

The trading market for our common stock will rely in part on the research and reports that industry or financial analysts publish about us or our business. We do not control these analysts. If one or more of the analysts who cover us downgrade our stock, our stock price would likely decline rapidly. If one or more of these analysts cease coverage of our company, we could lose visibility in the market, which in turn could cause our stock price to decline.

The concentration of our capital stock ownership with insiders will likely limit your ability to influence corporate matters.

Our executive officers, directors, current 5% or greater stockholders and entities affiliated with any of them together beneficially own a large percentage of our outstanding common stock. As a result, these stockholders, acting together, have substantial influence over all matters that require approval by our stockholders, including the election of directors and approval of significant corporate transactions. As a result, corporate actions might be taken even if other stockholders, including you, oppose them. This concentration of ownership might also have the effect of delaying or preventing a change of control of our company that other stockholders may view as beneficial.

Our management has broad discretion over the use of our cash, cash equivalents and marketable securities and might not apply these current assets in ways that enhance our results of operations.

Our management has broad discretion to use our cash, cash equivalents and marketable securities, which include net proceeds from our initial public offering and follow-on public offering, and you will be relying on the judgment of our management regarding the application of these assets. We intend to use a portion of the net proceeds from our initial public offering for leasehold improvements at our new corporate headquarters and manufacturing facility. Although we expect our management to use the remaining assets for general corporate purposes, including working capital and for potential strategic investments or acquisitions, we have not allocated these assets for specific purposes. Our management might not be able to yield a significant return, if any, on any investment of these assets. Our management might not use efficiently our cash, cash equivalents and marketable securities or in a manner that enhances our operating results.

Provisions of our certificate of incorporation and bylaws or Delaware law might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the trading price of our common stock.

Delaware corporate law and our certificate of incorporation and bylaws contain provisions that could discourage, delay or prevent a change in control of our company or changes in our management that the stockholders of our company may deem advantageous. These provisions:

- establish a classified board of directors so that not all members of our board are elected at one time;
- provide that directors may only be removed “for cause” and only with the approval of 66 2/3% of our stockholders;
- require super-majority voting to amend some provisions in our certificate of incorporation and bylaws;
- authorize the issuance of “blank check” preferred stock that our board could issue to increase the number of outstanding shares and to discourage a takeover attempt;
- limit the ability of our stockholders to call special meetings of stockholders;
- prohibit stockholder action by written consent, which requires all stockholder actions to be taken at a meeting of our stockholders;
- provide that the board of directors is expressly authorized to make, alter or repeal our bylaws; and
- establish advance notice requirements for nominations for election to our board or for proposing matters that can be acted upon by stockholders at stockholder meetings.

In addition, Section 203 of the Delaware General Corporation Law may discourage, delay or prevent a change in control of our company.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Foreign Currency Exchange Risk. Our revenues, except in Japan, and our expenses, except those expenses related to our Germany, United Kingdom, Japan and Korea operations, are denominated in U.S. dollars. Revenues and accounts receivable from our Japanese customers are denominated in Japanese Yen. We may purchase from time to time forward exchange contracts to hedge certain existing foreign currency denominated accounts receivable. Gains and losses on these contracts are generally recognized in income when the related transactions being hedged are recognized.

As of September 25, 2004, we had outstanding foreign exchange forward contracts to sell 1.0 billion Yen for \$8.7 million with contract rates ranging from 108.30 Yen to 110.66 Yen per U.S. dollar. Fluctuations in foreign currency exchange rates throughout the nine months ended September 25, 2004 and the unrealized loss or fair value of these contracts totaled \$597,000 as of September 25, 2004 and was recognized in income. The fair value of these foreign currency forward exchange contracts as of September 25, 2004 would have changed by \$860,000 if the foreign currency exchange rate for the Japanese yen to the U.S. dollar on these forward contracts had changed by 10%. We do not use derivative financial instruments for trading or speculative purposes.

Interest Rate Risk. The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive from our investments without significantly increasing risk. Some of the securities in which we invest may be subject to market risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with an interest rate fixed at the then-prevailing rate and the prevailing interest rate later rises, the principal amount of our investment will probably decline. To minimize this risk in the future, we intend to maintain our portfolio of cash equivalents and marketable securities in a variety of securities, including commercial paper, money market funds, government and non-government debt securities and certificates of deposit. The risk associated with fluctuating interest rates is limited to our investment portfolio and we do not believe that a 10% change in interest rates will have a significant impact on our interest income. As of September 25, 2004, all of our investments were in money market accounts, certificates of deposit or high quality corporate debt obligations and U.S. government securities.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, FormFactor management, including the Chief Executive Officer and Chief Financial Officer, conducted an evaluation as of the end of the period covered by this quarterly report on Form 10-Q, of the effectiveness of FormFactor's "disclosure controls and procedures" as defined in Exchange Act Rule 13a-15(e). Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of September 25, 2004, FormFactor's disclosure controls and procedures were effective for ensuring that information required to be disclosed in the reports that FormFactor files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms.

Internal Control Over Financial Reporting

As required by Rule 13a-15(d) of the Securities Exchange Act of 1934, FormFactor management, including the Chief Executive Officer and Chief Financial Officer, also conducted an evaluation of FormFactor's "internal control over financial reporting" as defined in Exchange Act Rule 13a-15(f) to determine whether any changes in FormFactor's internal control over financial reporting occurred during the third quarter of 2004 that materially affected, or are reasonably likely to materially affect, FormFactor's internal control over financial reporting. Based on that evaluation, there has been no such change during the third quarter of fiscal 2004.

Section 404 Assessment

Section 404 of the Sarbanes-Oxley Act requires management's annual review and evaluation of our internal controls, and an attestation of the effectiveness of these controls by our independent registered public accountants beginning with our Form 10-K for the fiscal year ending on December 25, 2004. We are dedicating significant resources, including management time and effort, and incurring substantial costs in connection with our ongoing Section 404 assessment. We are currently documenting and testing our internal controls and considering whether any improvements are necessary for maintaining an effective control environment at our company. The evaluation of our internal controls is being conducted under the direction of our senior management in consultation with a third party consulting firm. In addition, our management is regularly discussing the results of our testing and any proposed improvements to our control environment with the audit committee of our board of directors. We expect to assess our controls and procedures on a regular basis. We will continue to work to improve our controls and procedures, and to educate and train our employees on our existing controls and procedures in connection with our efforts to maintain an effective controls infrastructure at our company. Despite the mobilization of significant resources for our Section 404 assessment, we, however, cannot provide any assurance that we will timely complete the evaluation of our internal controls or that, even if we do complete the evaluation of our internal controls, we do so in time to permit our independent registered public accountants to timely complete their attestation procedures of our controls in a manner that will allow us to comply with applicable SEC rules and regulations by the filing deadline for our Form 10-K for fiscal year 2004.

Limitation on Effectiveness of Controls

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute, assurance that the objectives of the system are met. The design of any control system is based, in part, upon the benefits of the control system relative to its costs. Control systems can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the control. In addition, over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may deteriorate. Because of these and other inherent limitations of control systems, there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions, regardless of how remote.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we may be subject to legal proceedings and claims in the ordinary course of business. As of the filing date of this quarterly report, we were not involved in any material legal proceedings, other than as set forth below.

On February 24, 2004, we filed in the Seoul Southern District Court, located in Seoul, South Korea, two separate complaints against Phicom Corporation, a Korean corporation, alleging infringement of a total of four Korean patents issued to FormFactor. One Complaint alleges that Phicom is infringing our Korean Patent Nos. 252,457, entitled “Method of Fabricating Interconnections Using Cantilever Elements and Sacrificial Substrates,” and 324,064, entitled “Contact Tip Structures for Microelectronic Interconnection Elements and Methods of Making Same.” The other Complaint alleges Phicom is infringing our Korean Patent Nos. 278,342, entitled “Method of Altering the Orientation of Probe Elements in a Probe Card Assembly,” and 399,210, entitled “Probe Card Assembly.” Both of the Complaints seek injunctive relief. The court actions are a part of our ongoing efforts to protect the intellectual property embodied in our proprietary technology, including our MicroSpring interconnect technology. In March 2004, Phicom filed in the Korean Intellectual Property Office invalidity actions challenging the validity of some or all of the claims of each of our four Korean patents at issue. We could incur significant expenses in these litigations.

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

(a) Not applicable.

(b) The Securities and Exchange Commission declared our first registration statement, which we filed on Form S-1 (Registration No. 333-86738) under the Securities Act of 1933 in connection with the initial public offering of our common stock, effective on June 11, 2003. Under this registration statement, we registered 6,505,305 of these shares on our behalf and 394,695 of these shares on behalf of certain stockholders of FormFactor, including a director and officers of FormFactor.

All of the shares of our common stock that we registered were sold for the aggregate public offering price of \$96.6 million. The net proceeds to the company after paying underwriting discounts and commissions and offering costs was approximately \$82.0 million. In addition, the selling stockholders paid approximately \$2.7 million to the company from their net proceeds in the offering to repay loans from FormFactor.

As of September 25, 2004 we invested the net proceeds of the offering in investment-grade, interest bearing marketable securities.

(c) Not applicable.

Item 3. Defaults Upon Senior Securities

Not applicable.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

Item 5. Other Information

Not applicable.

[Table of Contents](#)

Item 6. Exhibits

The following exhibits are filed herewith:

Exhibit Number	Exhibit Description	Incorporated by Reference			Filed Herewith
		Form	Date	Number	
10.01	Amendment to Intel Corporation Purchase Agreement by and between Intel Corporation and the Registrant dated July 23, 2004				X
10.02*	Amendment to Intel Corporation Purchase Agreement by and between Intel Corporation and the Registrant dated August 18, 2004				X
31.01	Certification of Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
31.02	Certification of Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002				X
32.01**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002				X

* Confidential treatment has been requested for portions of this exhibit. These portions have been omitted from this Form 10-Q and have been filed separately with the Securities and Exchange Commission.

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

SIGNATURE

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

FORMFACTOR, INC.

By: _____ /s/ JENS MEYERHOFF
Jens Meyerhoff
Chief Operating Officer and
Chief Financial Officer
*(Principal Financial Officer and
Duly Authorized Officer)*

November 9, 2004

EXHIBIT INDEX

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AMENDMENT "T" TO THE
CAPITAL EQUIPMENT AND SERVICE AGREEMENT
BETWEEN
INTEL CORPORATION
AND
FORMFACTOR INC.
INTEL AGREEMENT NUMBER C-05673

Amendment Effective Date: 1/08/2004

WHEREAS, Intel and FormFactor, Inc. ("Seller), have entered into a Capital Equipment and Service Agreement, Intel Agreement No. C-05673 (hereinafter called "Agreement") dated 1/8/01, as amended by Amendment(s) O dated 1-22-01, Amendment P dated 4-23-01, Amendment Q dated 9-3-01, Amendment R dated 2/4/02, and by Amendment S dated 6/30/03; and

WHEREAS, both parties wish to amend the Agreement to extend the Term of the aforementioned Agreement through 1/8/2005 as forthwith described in this Amendment "T".

THEREFORE, for valuable consideration, the adequacy and receipt of which are hereby acknowledged, the parties agree as follows:

1. PRE-ESTABLISHED TERMS

All terms and conditions of the Agreement remain in full force and effect and apply to this Amendment, unless specifically modified below.

2. AGREEMENT MODIFICATIONS

The parties mutually agree to extend Term of the Agreement, including all of the aforementioned amendments thereto, through January 8, 2005.

AGREED:

INTEL CORPORATION

FORM FACTOR, INC.

By: /s/ Mike Dicken

By: /s/ Peter B. Mathews

Mike Dicken

Peter B. Mathews

(Printed Name)

(Printed Name)

Commodity Manager

Sr. VP - WW Sales

(Title)

(Title)

7/1/04

7/23/04

(Date)

(Date)

AMENDMENT NO U TO

INTEL CORPORATE EQUIPMENT AND SERVICE PURCHASE AGREEMENT NO. C-05673

BETWEEN

INTEL CORPORATION AND FORMFACTOR INC.

For valuable consideration, the receipt and sufficiency of which the parties hereby acknowledge, Intel Corporation ("Buyer") and Formfactor Inc. ("Seller") hereby amend the above referenced Intel Corporation Purchase Agreement No.C-05673 (the "Agreement") as set forth hereafter.

1. EFFECTIVE DATE.
The Effective Date of this amendment (the "Amendment") shall be 9-1-04.
2. DEFINITIONS.
Unless provided otherwise in this Amendment, each capitalized term appearing in this Amendment shall have the same meaning as given in the Agreement.
3. AMENDMENTS.
By executing this Amendment, Buyer and Seller are amending the Agreement to add the terms and conditions of the SLA as set forth in Exhibit A attached hereto and incorporated herein by this reference.
4. LEGAL EFFECT ON AGREEMENT.
As amended by this Amendment, all provisions of the Agreement shall remain in full force and effect. In the event of a conflict between this Amendment and the Agreement, this Amendment shall take precedence. This Amendment shall survive the termination or expiration of the Agreement.

INTEL CORPORATION

SELLER

BY: /s/ Mike Dicken

BY: /s/ David Browne

NAME: Mike Dicken

NAME: David Browne

TITLE: Commodity Manager

TITLE: Technical Sales Director

DATE: 8/18/04

DATE: 8/17/04

* * * Confidential treatment has been requested for portions of this exhibit. The copy filed herewith omits the information subject to the confidentiality request. Omissions are designated as * * *. A complete version of this exhibit has been filed separately with the Securities and Exchange Commission.

EXHIBIT A -INTEL FLASH SERVICE LEVEL AGREEMENT (SLA) TERM SHEET (8/9/04)

OBJECTIVES OF SLA: 1) Increase uptime and production flexibility at Intel through fast and predictable repair times. 2) Reduced Intel and FFI administrative and engineering overhead by eliminating per repair purchase orders and expediting. 3) Allow Intel to budget for Minor Repair Cost. Accomplish these three objectives with out degrading FFI quality and engineering responsiveness.

EFFECTIVE DATE: September 1, 2004

TERM OF SLA: 3 years from effective date

A. DEFINITIONS:

1. MAJOR REPAIR - Repair that includes * * * (removing all * * * and * * *) or * * *.
2. MINOR REPAIR - Repair that includes * * * or * * * of * * *, * * *, or * * *. Minor Repairs do not address cards that have * * * damage, * * * (removing all * * * and * * *) or * * *.
3. L0 - The primary objective of Level 0 (L0) is to enable fastest possible service/repair and still capture product quality and failure information. L0 is a service assessment that can be used to quickly identify repair actions. L0 assessment capability is available * * *.
4. L1 - Level 1 Failure Analysis provides failure verification and reports symptom only. Includes limited investigation, could involve SEM analysis. L1 must be completed * * *
5. L2 - Level 2 Failure Analysis provides failure mode verification, probable cause and corrective/preventative action, could involve SEM or chemical analysis. L2 must be completed * * *
6. NASC- North American Service Center located in Livermore CA.
7. ESC - European Service Center located in Dresden Germany
8. LEAD TIME (LT) - Time from receipt at FFI to shipment
9. SIU- sort interface unit

B. PRODUCTS COVERED BY THIS SLA: FFI * * * and * * * with * * * probe heads and parallelism from * * * to * * * that require a Minor Repair and were DAMAGED AFTER THE EFFECTIVE DATE.

C. FFI LEAD TIME AGREEMENT

1. For all Minor Repairs the LT will be:
 - a. * * * (Used for * * *)
 - i. L0 - * * * days
 - ii. L1 and L2 should not be returned to * * *, however if they were the LT would be shipment time plus * * * LT shown below.
 - b. * * * (uses * * * for all levels of Failure analysis)
 - i. L0 - * * * days
 - ii. L1 - * * * days
 - iii. L2 - * * * days
2. The quarterly on time delivery (OTD) commitment is a maximum of * * * per * * * (* * *%).
 - a. Only cards with a filled out TIQFF are considered in the OTD calculation.
 - b. The card is considered late if the lead-times shown above (1.a,b) are not met.

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- c. If this OTD is not met for * * * the quarterly * * * for the following quarter will * * * by * * *. The * * * will remain until quarterly OTD is met. By way of example, see the table below:

QUARTER	* * *	OTD	SERVICE CHARGE
Q1'04	* * *	* * *	\$* * *
Q2	* * *	* * *	\$* * *
Q3	* * *	* * *	\$* * *
Q4	* * *	* * *	\$* * *
Q1'05	* * *	* * *	\$* * *

D. QUARTERLY SERVICE CHARGE

1. Service Charge(SC) of \$* * * per * * * will be billed to Intel and re-assessed every * * *. Intel places a PO at the beginning of each quarter, and FFI bills monthly.
2. During reassessment if the Non warranty Minor Repairs in the previous * * * average to; (i) * * * the SC will * * * to \$* * * for the following * * *, (ii) * * * the SC will * * * by * * % for every * * * non warranty Minor repairs * * * for the following * * *. By way of example, if Minor Repairs were * * * in * * * and * * * in * * * (* * *) then the SC would * * * to \$* * * for * * *.
3. No additional charges for L0-L2 failure analysis reports on Minor repairs.

E. MINOR REPAIR FLOW

1. SIU damage occurs
2. Intel fills out TIQFF and selects one of the three boxes circled below. "Repair Only No FA" box should be selected for all damage cards needing L0 failure analysis. "Report Failure Symptom Only" should be selected for all damage cards needing L1 failure analysis. "Root Cause Required " should be selected for all damage cards needing L2 failure analysis. IF A BOX IS NOT SELECTED OR IF THE CARD IS RETURNED TO FFI WITH OUT A TIQFF IT WILL BE CLASSIFIED AS A L1. IF THE FAILURE ANALYSIS DETERMINES THAT THE CARD NEEDS A MAJOR REPAIR THEN STANDARD FAILURE ANALYSIS FEES WILL APPLY.

[GRAPHIC]

FFI CONFIDENTIAL INTEL CONFIDENTIAL 10/29/2004

* * * Confidential treatment has been requested for portions of this exhibit. The copy filed herewith omits the information subject to the confidentiality request. Omissions are designated as * * *. A complete version of this exhibit has been filed separately with the Securities and Exchange Commission.

3. If the SIU is damaged at Intel * * * or * * * and is a Minor Repair it should be sent to * * *. TO AVOID UNNECESSARY LEAD-TIME DELAYS ALL OTHER DAMAGED CARDS SHOULD BE SENT TO * * *.
4. If a return is not a Minor Repair and is non-warranty a failure report will be sent to Intel and a PO will be requested. If Intel decides not to repair or if the card is at FFI for * * * with out a response from Intel, the card will be returned as is to Intel and the standard FA fee will apply.

FFI CONFIDENTIAL INTEL CONFIDENTIAL 10/29/2004

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CERTIFICATION OF CHIEF EXECUTIVE OFFICER
PURSUANT TO 15 U.S.C. SECTION 7241, AS
ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Igor Y. Khandros, certify that:

1. I have reviewed the quarterly report on Form 10-Q of FormFactor, Inc., a Delaware corporation, for the period ended September 25, 2004, as filed with the Securities and Exchange Commission;
2. Based on my knowledge, the quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in the quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the quarterly report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in the quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the quarterly report based on such evaluation; and
 - (c) Disclosed in the quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2004

/s/ Igor Y. Khandros

Igor Y. Khandros
Chief Executive Officer

CERTIFICATION OF CHIEF FINANCIAL OFFICER
PURSUANT TO 15 U.S.C. SECTION 7241,
AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Jens Meyerhoff, certify that:

1. I have reviewed the quarterly report on Form 10-Q of FormFactor, Inc., a Delaware corporation, for the period ended September 25, 2004, as filed with the Securities and Exchange Commission;
2. Based on my knowledge, the quarterly report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by the quarterly report;
3. Based on my knowledge, the financial statements, and other financial information included in the quarterly report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in the quarterly report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which the quarterly report is being prepared;
 - (b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in the quarterly report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by the quarterly report based on such evaluation; and
 - (c) Disclosed in the quarterly report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting;
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors:
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 9, 2004

/s/ Jens Meyerhoff

Jens Meyerhoff
Chief Financial Officer

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

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

In connection with the quarterly report on Form 10-Q of FormFactor, Inc., a Delaware corporation, for the period ended September 25, 2004, as filed with the Securities and Exchange Commission, each of the undersigned officers of FormFactor, Inc. certifies pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, to his respective knowledge:

- (1) the quarterly report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and
- (2) the information contained in the quarterly report fairly presents, in all material respects, the financial condition and results of operations of FormFactor, Inc. for the periods presented therein.

Date: November 9, 2004

/s/ Igor Y. Khandros

Igor Y. Khandros
Chief Executive Officer

Date: November 9, 2004

/s/ Jens Meyerhoff

Jens Meyerhoff
Chief Financial Officer

A signed original of the above certification has been provided to FormFactor, Inc. and will be retained by FormFactor, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.