

FORMFACTOR INC
Form 10-Q/A
November 30, 2004

Table of Contents

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549**

**Form 10-Q/A
Amendment No. 1**

(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.

Table of Contents

EXPLANATORY NOTE

FormFactor is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q for the three and nine months period ended September 25, 2004 to amend and restate certain portions of its Form 10-Q filed with the Securities and Exchange Commission on November 9, 2004. This Amendment No. 1 presents net income (loss) available to common stockholders and restates FormFactor's calculation of basic and diluted net income (loss) available to common stockholders per share for the three and nine month periods ended September 27, 2003.

The restatement does not affect FormFactor's reported net income, or its balance sheet or cash flow statements for any period.

FormFactor did not previously reflect the impact of cumulative dividend rights and participating dividend rights of its redeemable convertible preferred stock in its calculation of net income (loss) available to common stockholders or in its calculation for either basic or diluted net income (loss) available to common stockholders per share, and has adjusted its calculations according to SFAS No. 128 Earnings Per Share and EITF Topic No. D-95, Effect of Participating Convertible Securities on the Computation of Basic Earnings per Share.

The adjustment relates to cumulative dividend rights of FormFactor's redeemable, convertible preferred stock Series B-G and participating dividend rights of FormFactor's redeemable, convertible preferred stock Series A-G, which were issued in years prior to FormFactor's initial public offering in June 2003. Such dividend rights impact the calculation of net income (loss) available to common stockholders regardless of whether a dividend was declared or paid. The contractual cumulative dividend rights and the participating dividend rights need to be considered in the calculation of basic net income (loss) available to common stockholders per share. For the calculation of diluted net income (loss) available to common stockholders per share, the convertible securities are included using the if-converted method to the extent the effect is dilutive.

Please see Note 9 to the Notes to Consolidated Financial Statements contained in this Amendment No. 1 for further information regarding the revisions to FormFactor's financial results.

This Amendment No. 1 amends and restates the following items of the initial filing of FormFactor's Form 10-Q: (i) Part I, Item 1 Unaudited Condensed Consolidated Financial Statements, (ii) Part I, Item 4 Controls and Procedures and (iii) Part II, Item 6 Exhibits.

All information in the FormFactor's Quarterly Report on Form 10-Q for the three and nine month periods ended September 25, 2004, as amended by this Amendment No. 1, speaks as of the date of the original filing of the FormFactor's Form 10-Q for such period and does not reflect any subsequent information or events, except as expressly noted in this Amendment No. 1 and except for Exhibits 31.01, 31.02, and 32.01. References to Annual Report, Form 10-K and Form 10-K/A in this Amendment No. 1 refer to FormFactor's Annual Report on Form 10-K for the fiscal year ended December 27, 2003, as amended. References to Quarterly Report and Form 10-Q in this Amendment No. 1, refer to FormFactor's Quarterly Report on Form 10-Q for the three and nine month periods ended September 25, 2004, as amended.

All information contained in this Amendment No. 1 is subject to updating and supplementing as provided in FormFactor's reports, as amended, filed with the Securities and Exchange Commission subsequent to the date of the initial filing of FormFactor's Quarterly Report on Form 10-Q for the three and nine months ended September 25, 2004.

FormFactor, Inc.
Form 10-Q/A for the Quarterly Period Ended September 25, 2004
Index

| | Page |
|---|-------------|
| <u>Part I.</u> | |
| <u>Financial Information</u> | 3 |
| <u>Item 1.</u> | |
| <u>Unaudited Condensed Consolidated Financial Statements</u> | 3 |
| | 3 |

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| | |
|---|----|
| <u>Unaudited Condensed Consolidated Income Statements for the three and nine months ended September 27, 2003 and September 25, 2004</u> | |
| <u>Unaudited Condensed Consolidated Balance Sheets as of December 27, 2003 and September 25, 2004</u> | 4 |
| <u>Unaudited Condensed Consolidated Statements of Cash Flows for the nine months ended September 27, 2003 and September 25, 2004</u> | 5 |
| <u>Notes to Unaudited Condensed Consolidated Financial Statements</u> | 6 |
| <u>Item 4. Controls and Procedures</u> | 13 |
| Part II. Other Information | 14 |
| <u>Item 6. Exhibits</u> | |
| <u>Signature</u> | 14 |
| <u>Exhibit</u> | |
| <u>Index</u> | 15 |
| <u>EXHIBIT 31.01</u> | |
| <u>EXHIBIT 31.02</u> | |
| <u>EXHIBIT 32.01</u> | |

Table of Contents**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 |
| | As restated | | As restated | |
| 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 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Gross margin | 12,700 | 25,752 | 31,906 | 67,528 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| 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 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Total operating expenses | 9,584 | 13,914 | 26,690 | 36,631 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Operating income | 3,116 | 11,838 | 5,216 | 30,897 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Interest income | 289 | 635 | 625 | 1,740 |
| Interest expense | (11) | | (38) | |
| Other income (expense), net | 242 | (156) | 193 | (798) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| | 520 | 479 | 780 | 942 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

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| | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| Income before income taxes | 3,636 | 12,317 | 5,996 | 31,839 |
| Provision for income taxes | (1,395) | (4,820) | (2,300) | (12,483) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net income | 2,241 | 7,497 | 3,696 | 19,356 |
| Preferred stock dividend | | | (2,340) | |
| Amount allocated to participating preferred stockholders | | | (10) | |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net income available to common stockholders | \$ 2,241 | \$ 7,497 | \$ 1,346 | \$ 19,356 |

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

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

| | December 27, 2003 | September 25, 2004 |
|---|----------------------------------|-----------------------------------|
| | As restated | |
| 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 |
| | <hr/> | <hr/> |
| Total current assets | 212,562 | 231,532 |
| 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 |
| | <hr/> | <hr/> |
| Total assets | \$ 237,165 | \$ 282,440 |
| 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 |
| | <hr/> | <hr/> |
| Total current liabilities | 21,718 | 34,215 |
| Deferred revenue and customer advances | 433 | 254 |
| | <hr/> | <hr/> |
| Total liabilities | 22,151 | 34,469 |

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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 |
| | <u> </u> | <u> </u> |
| | | |
| 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.

Table of Contents**FORMFACTOR, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited, in thousands)**

| | Nine Months Ended | |
|---|-----------------------------------|-------------------------------|
| | September 27, 2003 | September 25, 2004 |
| | As restated | |
| 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 |
| | <hr/> | <hr/> |
| Net cash provided by operating activities | 6,884 | 16,644 |
| | <hr/> | <hr/> |
| 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 |
| | <hr/> | <hr/> |
| Net cash used in investing activities | (21,341) | (75,326) |
| | <hr/> | <hr/> |
| Cash flows from financing activities: | | |
| Proceeds from issuance of common stock, net | 82,850 | 7,950 |

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| | | |
|--|-------------------|-------------------|
| 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) | |
| | <u> </u> | <u> </u> |
| Net cash provided by financing activities | 83,208 | 8,611 |
| | <u> </u> | <u> </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 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents, end of the period | \$ 95,561 | \$ 66,226 |
| | <u> </u> | <u> </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.

Table of Contents**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/A Amendment No. 2 for the year ended December 27, 2003, 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 |
|------------------|----------------------------------|-------------------------------|
| | <hr/> | <hr/> |
| Raw materials | \$3,128 | \$ 4,079 |
| Work-in-progress | 4,628 | 5,845 |
| Finished goods | 269 | 126 |
| | <hr/> | <hr/> |
| | \$8,025 | \$10,050 |
| | <hr/> | <hr/> |

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):

| | <u>Three Months Ended</u> | | <u>Nine Months Ended</u> | |
|---|-----------------------------------|-----------------------------------|-----------------------------------|-----------------------------------|
| | <u>September 27, 2003</u> | <u>September 25, 2004</u> | <u>September 27, 2003</u> | <u>September 25, 2004</u> |
| 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) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Ending balance | <u>\$ 536</u> | <u>\$ 494</u> | <u>\$ 536</u> | <u>\$ 494</u> |

Table of Contents

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 option expense.

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 and net income (loss) available to common stockholders per share would have been changed to the pro-forma amounts as follows:

| | Three Months Ended | | Nine Months Ended | |
|---|--|-----------------------|-----------------------|--------------------------|
| | September 27, 2003 | September 25, 2004 | September 27, 2003 | September 25, 2004 |
| | As restated | As restated | As restated | As restated |
| | (In thousands, except per share amounts) | | | |
| Reported net income (see Note 9) | \$ 2,241 | \$ 7,497 | \$ 3,696 | \$ 19,356 |
| Add: Stock-based employee compensation expense included in reported net, net of tax | 609 | 472 | 1,811 | 1,558 |
| Deduct: Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax | (2,431) | (2,259) | (4,721) | (6,937) |
| | \$ 419 | \$ 5,710 | \$ 786 | \$ 13,977 |
| Net income (loss) available to common stockholders per share: | | | | |
| Basic: | | | | |
| As reported | \$ 0.07 | \$ 0.20 | \$ 0.08 | \$ 0.52 |
| Pro forma | \$ 0.01 | \$ 0.15 | \$ (0.09) | \$ 0.37 |
| Diluted: | | | | |
| As reported | \$ 0.06 | \$ 0.19 | \$ 0.06 | \$ 0.48 |
| Pro forma | \$ 0.01 | \$ 0.14 | \$ (0.09) | \$ 0.35 |

Table of Contents

The Company has adopted the disclosure only provisions of SFAS No. 123. Prior to the Company's initial public offering, 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 (loss) 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 \$7.61, and was \$8.73 and \$8.43 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 available to common stockholders per share is computed by dividing the net income available to common stockholders by the weighted-average number of common shares outstanding for the period. The net income available to common stockholders is calculated by deducting the cumulative preferred stock dividends, if any, and dividends allocable to participating preferred stockholders, if any, from net income to determine the net income available to common stockholders.

Diluted net income available to common stockholders per share is computed giving effect in all potential diluted common stock, including options, warrants and common stock subject to repurchase using the treasury stock method and all convertible securities using the if-converted method to the extent the effect is dilutive.

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

| Three Months Ended | | Nine Months Ended | |
|---------------------------|---------------------------|---------------------------|---------------------------|
| Sept. 27, 2003 | Sept. 25, 2004 | Sept. 27, 2003 | Sept. 25, 2004 |
| As restated | | As restated | |

Basic net income per share (see Note 9)

Numerator:

| | | | | |
|---|-------------------|-------------------|-------------------|-------------------|
| Net income available to common stockholders | \$ 2,241 | \$ 7,497 | \$ 1,346 | \$ 19,356 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

Denominator:

| | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| Weighted-average common stock outstanding | 34,246 | 37,769 | 16,654 | 37,691 |
| Less weighted-average shares subject to repurchase | (164) | (137) | (173) | (107) |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

| | | | | |
|--|-------------------|-------------------|-------------------|-------------------|
| Weighted-average shares used in computing basic net income per share | 34,082 | 37,632 | 16,481 | 37,584 |
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |

Table of Contents

| | Three Months Ended | | Nine Months Ended | |
|--|---------------------------|---------------------------|---------------------------|---------------------------|
| | Sept. 27, 2003 | Sept. 25, 2004 | Sept. 27, 2003 | Sept. 25, 2004 |
| | As restated | | As restated | |
| Diluted net income per share | | | | |
| Numerator: | | | | |
| Net income available to common stockholders | \$ 2,241 | \$ 7,497 | \$ 1,346 | \$19,356 |
| Add preferred dividends for each Series considered dilutive | | | 117 | |
| Net income available to common stockholders | <u>\$ 2,241</u> | <u>\$ 7,497</u> | <u>\$ 1,463</u> | <u>\$19,356</u> |
| Denominator: | | | | |
| Weighted-average shares used in computing basic net income per share | 34,082 | 37,632 | 16,481 | 37,584 |
| Add stock options, warrants and common stock subject to repurchase | 3,008 | 2,867 | 2,160 | 2,906 |
| Add preferred shares for each Series considered dilutive | | | 5,838 | |
| Weighted-average shares used in computing diluted net income per share | <u>37,090</u> | <u>40,499</u> | <u>24,479</u> | <u>40,490</u> |

The following options to purchase common stock and convertible preferred stock were excluded from the computation of diluted net income (loss) 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 | 586 | 1,346 | 773 | 861 |
| Convertible preferred stock | | | 17,164 | |

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.

Table of Contents**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 |
| | As restated | | As restated | |
| 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 |
|--|----------------------------------|-----------------------------------|
| | <u> </u> | <u> </u> |
| Unrealized gain on marketable securities, net of tax | \$ 47 | \$ (184) |
| Cumulative translation adjustments | <u>(51)</u> | <u>(90)</u> |
| | | |
| 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.

Table of Contents

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 Restatement of Financial Statements

The Company is restating its financial results for the nine month period ended September 27, 2003 to reflect an adjustment to its calculation of basic and diluted net income (loss) available to common stockholders per share.

The restatement does not affect the Company's reported net income, or its balance sheet or cash flow statements for any period.

The Company did not previously reflect the impact of cumulative dividend rights and participating dividend rights of its redeemable convertible preferred stock in its calculation for either basic or diluted net income (loss) available to common stockholders per share and has adjusted its calculations according to SFAS No. 128 Earnings Per Share and EITF Topic No. D-95, Effect of Participating Convertible Securities on the Computation of Basic Earnings per Share.

The adjustment relates to cumulative dividend rights of the Company's redeemable, convertible preferred stock Series B-G and participating dividend rights of the Company's redeemable, convertible preferred stock Series A-G, which were issued in years prior to the Company's initial public offering in June 2003. Such dividend rights impact the calculation of basic and diluted net income (loss) available to common stockholders per share regardless of whether a dividend was declared or paid. The contractual cumulative dividend rights and the participating dividend rights need to be considered in the calculation of basic net income (loss) available to common stockholders per share. For the calculation of diluted net income (loss) available to common stockholders per share, the convertible securities are included using the if-converted method to the extent the effect is dilutive. In conjunction with this restatement, the Company has also revised its pro forma net income (loss) calculation and the related per share amount disclosures under SFAS No. 123 Accounting for Stock Based Compensation to reflect changes to the net income (loss) available to common stockholders and to correct the amounts presented for the stock-based compensation pro forma adjustments for all periods (the net effect of the change in the pro forma adjustments was to decrease the pro forma net income for the three and nine months ended September 27, 2003, by \$688,000 and \$1,135,000, respectively, and to decrease pro forma net income for the three and nine months ended September 25, 2004 by \$391,000 and \$1,785,000, respectively).

| | Nine Months Ended | |
|--------------------------|---|-------------------------------|
| | September 27, 2003 | September 27, 2003 |
| | As reported⁽¹⁾ | As restated |
| | (In thousands, except per share amounts) | |
| Net income | \$3,696 | \$ 3,696 |
| Preferred stock dividend | (2,510) | (2,340) |
| | | (10) |

Amount allocated to participating preferred stockholders

| | | |
|---|----------|----------|
| | _____ | _____ |
| Net income available to common stockholders | \$ 1,186 | \$ 1,346 |
| Net income available to common stockholders per share: | | |
| Basic | \$ 0.07 | \$ 0.08 |
| Diluted | \$ 0.04 | \$ 0.06 |
| Weighted-average number of shares used in per share calculations: | | |
| Basic | 16,629 | 16,589 |
| Diluted | 33,133 | 24,587 |

1) As reported in the Quarterly Report on Form 10-Q for the quarter ended September 25, 2004 as filed on November 9, 2004, amounts were previously restated to reflect adjustments to the amortization schedule of deferred stock-based compensation and the related income taxes for the nine months ended September 27, 2003, resulting in a decrease in net income of \$795,000 and diluted earnings per share of \$0.10.

Note 10 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 March 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. It requires that prior period earnings per share amounts be restated to ensure comparability period over period. The adoption of EITF No. 03-6 had no impact on the Company's earnings per share (after giving effect to the restatement described above) as the Company had included its redeemable convertible preferred stock as participating securities in prior periods. All of the redeemable convertible preferred stock was converted to common stock in connection with the Company's IPO in June 2003.

Note 11 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.

Table of Contents

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, FormFactor's 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.

In the light of two restatements of previously issued financial statements, as described below, FormFactor's management, including its Chief Executive Officer, its Chief Financial Officer and its newly appointed President, as well as its Audit Committee, have concluded that a material weakness in internal control over financial reporting exists. Because of the importance of internal control over financial reporting to the effectiveness of a company's disclosure controls and procedures, FormFactor's management has concluded that its disclosure controls and procedures are not currently effective. To address the deficiency, FormFactor has taken and expects to take the steps described below.

Internal Control over Financial Reporting

Pursuant to the Public Company Accounting Oversight Board's Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements*, effective June 17, 2004, a restatement is by definition a significant deficiency in a company's internal control over financial reporting and is a strong indicator that a material weakness in internal control over financial reporting exists. Amendment No. 1 to FormFactor's Annual Report on Form 10-K restated its financial results for fiscal years 2001, 2002 and 2003 to reflect a change in the amortization schedule of deferred stock-based compensation recorded in connection with its June 2003 initial public offering and to reflect a portion of its stock-based compensation amortization in cost of revenues. Amendment No. 2 to FormFactor's Annual Report on Form 10-K presents net income (loss) available to common stockholders and restates its basic and diluted net income (loss) available to common stockholders per share for fiscal years 1999 through 2003 and its pro forma net income (loss) calculation and the related per share amount disclosures under SFAS No. 123 *Accounting for Stock-based Compensation* but does not affect FormFactor's reported net income, or its balance sheet or cash flow statement for any period.

Under applicable rules, management may not conclude that a company's internal control over financial reporting is effective if a material weakness exists. Given the nature of the two restatements, FormFactor believes that the material weakness relates to insufficient personnel resources and technical accounting expertise within its accounting function. FormFactor believes that it has already taken substantial steps toward remediation of this material weakness and is taking additional steps to cure the weakness. Prior to discovering the error giving rise to the second restatement, FormFactor had hired an internal audit director, a new tax director and an additional accounting manager. Since the promotion of Mr. Jens Meyerhoff from Chief Financial Officer to Chief Operating Officer in April of 2004, FormFactor has actively sought and continues to seek to hire a new Chief Financial Officer and to hire additional personnel in its accounting department in a challenging job market for such skills. FormFactor believes that these steps should adequately address the identified material weakness in control over financial reporting.

Table of Contents

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 independent third party consulting firms. In addition, our management is regularly discussing the results of our testing and any proposed improvements to our control environment with our Audit Committee. 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 test our controls and 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.

Limitations 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 will be 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. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events.

Jens Meyerhoff
Chief Operating Officer and
Chief Financial Officer
*(Principal Financial Officer and
Duly Authorized Officer)*

November 30, 2004

Table of Contents**EXHIBIT INDEX**

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | Filed Herewith |
|---------------------------|---|----------------------------------|-------------|---------------|---------------------------|
| | | Form | Date | Number | |
| 10.01(1) | Amendment to Intel Corporation Purchase Agreement by and between Intel Corporation and the Registrant dated July 23, 2004 | 10-Q | 11/9/04 | 10.01 | |
| 10.02*(1) | Amendment to Intel Corporation Purchase Agreement by and between Intel Corporation and the Registrant dated August 18, 2004 | 10-Q | 11/9/04 | 10.02 | |
| 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.

(1) Filed with initial filing of the Form 10-Q on November 9, 2004.