

FORMFACTOR INC  
Form 10-Q  
October 28, 2015

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 26, 2015

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

7005 Southfront Road, Livermore, California 94551  
(Address of principal executive offices, including zip code)

(925) 290-4000  
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of the Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definition of "large accelerated filer", "accelerated filer" and "smaller reporting

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company” in Rule 12b-2 of the Exchange Act. (Check one):

Large Accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

(Do not check if a smaller reporting company)

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

As of October 27, 2015, 58,160,215 shares of the registrant’s common stock, par value \$0.001 per share, were outstanding.

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FORMFACTOR, INC.

FORM 10-Q FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 26, 2015

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements (Unaudited)

## FORMFACTOR, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

|   | Three Months Ended    |                       | Nine Months Ended     |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 26,<br>2015 | September 27,<br>2014 | September 26,<br>2015 | September 27,<br>2014 |
| Revenues  | \$65,862              | \$ 73,933             | \$210,576             | \$ 197,245            |
| Cost of revenues  | 47,407                | 49,791                | 146,028               | 140,754               |
| Gross profit  | 18,455                | 24,142                | 64,548                | 56,491                |
| Operating expenses:   |                       |                       |                       |                       |
| Research and development  | 10,645                | 11,198                | 32,947                | 32,019                |
| Selling, general and administrative                               | 11,108                | 13,309                | 34,373                | 38,754                |
| Restructuring charges, net  | 59                    | 28                    | 562                   | 2,084                 |
| Impairment of long-lived assets                                   | —                     | 86                    | 8                     | 829                   |
| Total operating expenses  | 21,812                | 24,621                | 67,890                | 73,686                |
| Operating loss  | (3,357 )              | (479 )                | (3,342 )              | (17,195 )             |
| Interest income, net  | 65                    | 75                    | 213                   | 233                   |
| Other income (expense), net                                       | 982                   | 228                   | 2,584                 | 6                     |
| Loss before income taxes  | (2,310 )              | (176 )                | (545 )                | (16,956 )             |
| Provision for income taxes  | 215                   | 101                   | 359                   | 358                   |
| Net loss  | \$(2,525 )            | \$ (277 )             | \$ (904 )             | \$ (17,314 )          |
| Net loss per share:   |                       |                       |                       |                       |
| Basic and Diluted   | \$(0.04 )             | \$ 0.00               | \$(0.02 )             | \$ (0.31 )            |
| Weighted-average number of shares used in per share calculations: |                       |                       |                       |                       |
| Basic and Diluted   | 58,209                | 56,297                | 57,757                | 55,720                |

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

FORMFACTOR, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(In thousands)

(Unaudited)

|  | Three Months Ended |               | Nine Months Ended |               |
|--|--------------------|---------------|-------------------|---------------|
|  | September 26,      | September 27, | September 26,     | September 27, |
|  | 2015               | 2014          | 2015              | 2014          |
| Net loss   | \$ (2,525 )        | \$ (277 )     | \$ (904 )         | \$ (17,314 )  |
| Other comprehensive loss, net of tax:                        |                    |               |                   |               |
| Foreign currency translation adjustments                     | (161 )             | (814 )        | (409 )            | (376 )        |
| Unrealized gains on available-for-sale marketable securities | (7 )               | 1             | 4                 | 25            |
| Other comprehensive loss, net of tax                         | (168 )             | (813 )        | (405 )            | (351 )        |
| Comprehensive loss   | \$ (2,693 )        | \$ (1,090 )   | \$ (1,309 )       | \$ (17,665 )  |

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

## FORMFACTOR, INC.

## CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

(Unaudited)

|   | September 26,<br>2015 | December 27,<br>2014 |
|---|-----------------------|----------------------|
| <b>ASSETS</b>   |                       |                      |
| Current assets:   |                       |                      |
| Cash and cash equivalents   | \$ 142,185            | \$ 113,940           |
| Marketable securities   | 41,654                | 49,897               |
| Accounts receivable, net  | 36,682                | 45,152               |
| Inventories, net  | 27,000                | 25,548               |
| Deferred tax assets   | 2,029                 | 2,036                |
| Refundable income taxes   | —                     | 782                  |
| Prepaid expenses and other current assets   | 6,501                 | 6,919                |
| Total current assets  | 256,051               | 244,274              |
| Restricted cash   | 435                   | 435                  |
| Property, plant and equipment, net  | 23,821                | 25,498               |
| Goodwill  | 30,731                | 30,731               |
| Intangibles, net  | 28,869                | 38,689               |
| Deferred tax assets   | 3,440                 | 3,466                |
| Other assets  | 865                   | 1,150                |
| Total assets  | \$ 344,212            | \$ 344,243           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Current liabilities:  |                       |                      |
| Accounts payable  | \$ 21,159             | \$ 20,274            |
| Accrued liabilities   | 18,492                | 21,217               |
| Income taxes payable  | 166                   | 68                   |
| Deferred revenue  | 4,215                 | 6,303                |
| Total current liabilities   | 44,032                | 47,862               |
| Long-term income taxes payable  | 1,034                 | 1,094                |
| Deferred tax liabilities  | 2,208                 | 2,208                |
| Deferred rent and other liabilities   | 3,404                 | 3,643                |
| Total liabilities   | 50,678                | 54,807               |
| Commitments and contingencies (Note 16)   |                       |                      |
| Stockholders' equity:   |                       |                      |
| Preferred stock, \$0.001 par value:   |                       |                      |
| 10,000,000 shares authorized; no shares issued and outstanding at September 26, 2015<br>and December 27, 2014, respectively                         | —                     | —                    |
| Common stock, \$0.001 par value:  |                       |                      |
| 250,000,000 shares authorized; 58,160,215 and 56,518,428 shares issued and<br>outstanding at September 26, 2015 and December 27, 2014, respectively | 58                    | 57                   |
| Additional paid-in capital  | 717,082               | 711,676              |
| Accumulated other comprehensive loss  | (2,166                | ) (1,761 )           |
| Accumulated deficit   | (421,440              | ) (420,536 )         |
| Total stockholders' equity  | 293,534               | 289,436              |
| Total liabilities and stockholders' equity  | \$ 344,212            | \$ 344,243           |

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

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## FORMFACTOR, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

|   | Nine Months Ended  |                    |
|---|--------------------|--------------------|
|   | September 26, 2015 | September 27, 2014 |
| Cash flows from operating activities:                                       |                    |                    |
| Net loss  | \$(904             | ) \$(17,314 )      |
| Adjustments to reconcile net loss to net cash used in operating activities: |                    |                    |
| Depreciation and amortization   | 17,875             | 24,155             |
| (Accretion) amortization of discount on investments                         | (1                 | ) 199              |
| Stock-based compensation expense  | 8,515              | 10,023             |
| Deferred income tax provision (benefit)                                     | 7                  | (44 )              |
| (Recovery) provision for doubtful accounts receivable                       | (11                | ) 1                |
| Provision for excess and obsolete inventories                               | 4,886              | 5,530              |
| (Gain) loss on disposal, write-off and sale of long-lived assets            | (1,009             | ) 41               |
| Impairment of long-lived assets   | 8                  | 829                |
| Non-cash restructuring  | 500                | 600                |
| Foreign currency transaction (gains) losses                                 | (191               | ) 880              |
| Changes in assets and liabilities:  |                    |                    |
| Accounts receivable   | 8,327              | (17,918 )          |
| Inventories   | (6,337             | ) (10,725 )        |
| Prepaid expenses and other current assets                                   | 143                | (1,087 )           |
| Refundable income taxes   | 782                | —                  |
| Other assets  | 250                | 16                 |
| Accounts payable  | 1,242              | 5,998              |
| Accrued liabilities   | (2,906             | ) 5,484            |
| Income tax payable  | 36                 | 160                |
| Deferred rent and other liabilities   | 79                 | 151                |
| Deferred revenues   | (2,090             | ) (1,564 )         |
| Net cash provided by operating activities                                   | 29,201             | 5,415              |
| Cash flows from investing activities:                                       |                    |                    |
| Acquisition of property, plant and equipment                                | (6,644             | ) (4,539 )         |
| Proceeds from sale of intellectual property and plant and equipment         | 1,200              | 820                |
| Proceeds from sale of subsidiary  | 44                 | 85                 |
| Purchases of marketable securities  | (41,253            | ) (31,693 )        |
| Proceeds from maturities of marketable securities                           | 49,500             | 58,323             |
| Net cash provided by investing activities                                   | 2,847              | 22,996             |
| Cash flows from financing activities:                                       |                    |                    |
| Proceeds from issuances of common stock                                     | 3,418              | 2,813              |
| Purchase and retirement of common stock                                     | (6,996             | ) —                |
| Payments made on capital leases   | —                  | (271 )             |
| Net cash (used in) provided by financing activities                         | (3,578             | ) 2,542            |
| Effect of exchange rate changes on cash and cash equivalents                | (225               | ) (885 )           |
| Net increase in cash and cash equivalents                                   | 28,245             | 30,068             |
| Cash and cash equivalents, beginning of period                              | 113,940            | 59,196             |
| Cash and cash equivalents, end of period                                    | \$ 142,185         | \$ 89,264          |
| Supplemental cash flow disclosures:   |                    |                    |



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|  |        |   |          |   |
|--|--------|---|----------|---|
| Changes in accounts payable and accrued liabilities related to property, plant and equipment purchases | \$(262 | ) | \$(1,105 | ) |
| Income and property taxes (refunded) paid, net   | \$(94  | ) | \$ 789   |   |

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 and Summary of Significant Accounting Policies

Basis of presentation. The accompanying unaudited condensed consolidated interim financial statements of FormFactor, Inc. and our subsidiaries have been prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and pursuant to the instructions to Form 10-Q and Article 10 of Regulation S-X of the U.S. Securities and Exchange Commission (the “SEC”). Our interim financial statements do not include all of the information and footnotes required by generally accepted accounting principles for annual financial statements. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary to fairly present our financial position, results of operations and cash flows have been included. Operating results for the three and nine months ended September 26, 2015 are not necessarily indicative of the results that may be expected for the year ending December 26, 2015, or for any other period. The balance sheet at December 27, 2014 has been derived from the audited consolidated financial statements at that date but does not include all of the information and footnotes required by GAAP for complete financial statements. The condensed consolidated financial statements include our accounts as well as those of our wholly-owned subsidiaries after elimination of all inter-company balances and transactions.

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

These financial statements and notes should be read with the consolidated financial statements and notes for the year ended December 27, 2014 included in our Annual Report on Form 10-K filed with the SEC on March 6, 2015.

Fiscal year. We operate on a 52/53 week fiscal year, whereby the fiscal year ends on the last Saturday of December. Fiscal 2015 and 2014 each contain 52 weeks and the three and nine months ended September 26, 2015 and September 27, 2014 each contained 13 and 39 weeks, respectively. Fiscal 2015 will end on December 26, 2015.

Critical Accounting Policies. Our critical accounting policies have not changed during the three and nine months ended September 26, 2015 from those disclosed in our Annual Report on Form 10-K for the year ended December 27, 2014.

Note 2 — Concentration of Credit and Other Risks

Financial instruments that potentially subject us to concentrations of credit risk consist primarily of cash equivalents, marketable securities and trade receivables. Our cash equivalents and marketable securities are held in safekeeping by large, credit worthy financial institutions. We invest our excess cash primarily in U.S. banks, government and agency bonds, money market funds and corporate obligations. We have established guidelines relative to credit ratings, diversification and maturities that seek to maintain safety and liquidity. Deposits in these banks may exceed the amounts of insurance provided on such deposits. To date, we have not experienced any losses on our deposits of cash and cash equivalents.

We market and sell our products to a narrow base of customers and generally do not require collateral. The following customers accounted for more than 10% of our revenues for the periods indicated:

| Three Months Ended | Nine Months Ended |
|--------------------|-------------------|
|--------------------|-------------------|

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|          | September<br>26, 2015 | September<br>27, 2014 | September 26,<br>2015 | September 27,<br>2014 |
|----------|-----------------------|-----------------------|-----------------------|-----------------------|
| Samsung  | 23.1                  | 10.8                  | 16.4                  | *                     |
| Intel    | 18.1                  | 18.9                  | 17.9                  | 18.3                  |
| SK hynix | 15.6                  | 15.6                  | 15.3                  | 18.0                  |
| Micron   | *                     | 16.6                  | 12.6                  | 14.6                  |
|          | 56.8                  | 61.9                  | 62.2                  | 50.9                  |

\* Less than 10% of revenues.

At September 26, 2015, two customers accounted for 28% and 14% of gross accounts receivable. At December 27, 2014, two customers accounted for approximately 26% and 18% of gross accounts receivable. No other customers accounted for more than 10% of gross accounts receivable at either of these fiscal period ends. We operate in the intensely competitive semiconductor industry, including the Dynamic Random Access Memory, or DRAM, Flash memory, and System-on-Chip, or SoC markets, which have been characterized by price erosion, rapid technological change, short product life cycles and heightened foreign and domestic competition. Significant technological changes in the industry could adversely affect our operating results.

Certain components for our wafer probe card products that meet our requirements are available only from a limited number of suppliers. The rapid rate of technological change and the necessity of developing and manufacturing products with short life cycles may intensify our reliance on such suppliers. The inability to obtain components as required, or to develop alternative sources, if and as required in the future, could result in delays or reductions in product shipments, which in turn could have a material adverse effect on our business, financial condition, results of operations or cash flows.

### Note 3 — Goodwill and Intangible Assets

Goodwill recorded from the acquisition of MicroProbe on October 16, 2012 was \$30.7 million as of September 26, 2015 and remained unchanged from the amounts recorded as of December 27, 2014. The Company has not recorded any historical goodwill impairments as of September 26, 2015.

The changes in intangible assets during the nine months ended September 26, 2015 and the net book value of intangible assets as of September 26, 2015 and December 27, 2014 were as follows (in thousands):

|                                      | Intangible Assets, Gross Amount |                     | Accumulated Amortization |                   |              | Intangible Assets, Net |                   | Weighted Average Useful Life |                    |
|--------------------------------------|---------------------------------|---------------------|--------------------------|-------------------|--------------|------------------------|-------------------|------------------------------|--------------------|
|                                      | December 27, 2014               | Additions/Disposals | September 26, 2015       | December 27, 2014 | Expense, net | September 26, 2015     | December 27, 2014 |                              | September 26, 2015 |
| Other Intangible Assets (1)          |                                 |                     |                          |                   |              |                        |                   |                              |                    |
| Existing developed technologies (2)  | \$45,300                        | \$ 2,400            | \$ 47,700                | \$29,097          | \$7,830      | \$ 36,927              | \$16,203          | \$ 10,773                    | 2.0                |
| Trade name                           | 4,388                           | —                   | 4,388                    | 970               | 328          | 1,298                  | 3,418             | 3,090                        | 7.0                |
| Customer relationships               | 17,000                          | —                   | 17,000                   | 4,832             | 1,662        | 6,494                  | 12,168            | 10,506                       | 5.0                |
| Total finite-lived intangible assets | 66,688                          | 2,400               | 69,088                   | 34,899            | 9,820        | 44,719                 | 31,789            | 24,369                       |                    |
| In-process research and development  | 6,900                           | (2,400)             | 4,500                    | —                 | —            | —                      | 6,900             | 4,500                        |                    |
| Total intangible assets              | \$73,588                        | \$ —                | \$ 73,588                | \$34,899          | \$9,820      | \$ 44,719              | \$38,689          | \$ 28,869                    |                    |

(1 ) Excludes fully amortized intangible assets

(2 ) As of September 26, 2015, we excluded approximately \$5.9 million of fully amortized existing developed technology intangible assets from gross intangible assets and accumulated amortization due to the sale of these

intangible assets to MarTek Inc. These intangible assets were fully amortized as of December 27, 2014 but were in use until their sale to MarTek Inc. Refer to Note 16 to the Condensed Consolidated Financial Statements-Commitments and Contingencies, for further details.

During the nine months ended September 26, 2015, a purchased in-process research and development ("IPR&D") project with a carrying value of \$2.4 million was completed and reclassified as a finite-lived intangible asset, and is currently being amortized over its estimated useful life.

The remaining IPR&D asset is classified as an indefinite lived intangible asset that is not currently subject to amortization but is reviewed for impairment annually or whenever events or changes in circumstances indicate that the carrying value of such asset may not be recoverable. The IPR&D asset will be subject to amortization upon completion of its respective research project and at the start of commercialization. The fair value assigned to the IPR&D asset was determined using the income approach based on estimates and judgments regarding risks inherent in the development process, including the likelihood of achieving technological success and market acceptance. If the IPR&D project is abandoned, the acquired technology attributable to the project will be expensed in the Condensed Consolidated Statements of Operations.

For the three and nine months ended September 26, 2015, amortization expense of \$2.7 million and \$0.7 million, and \$7.8 million and \$2.0 million, respectively, was included in cost of revenues and selling, general and administrative expenses, respectively. For the three and nine months ended September 27, 2014, amortization expense of \$4.4 million and \$0.7 million, and \$13.2 million and \$2.0 million, respectively, was included in cost of revenues and selling, general and administrative expenses, respectively.

Based on the carrying values of the finite-lived intangible assets recorded as of September 26, 2015 and assuming no subsequent additions to or impairment of the underlying assets, the remaining estimated annual amortization expense is expected to be as follows (in thousands):

| Fiscal Year    | Amount    |
|----------------|-----------|
| 2015           | \$ 3,317  |
| 2016           | 9,511     |
| 2017           | 3,314     |
| 2018           | 2,949     |
| 2019           | 2,447     |
| and thereafter | 2,831     |
| Total          | \$ 24,369 |

#### Note 4 — Restructuring Charges

Restructuring charges include costs related to employee termination benefits, cost of long-lived assets abandoned or impaired, as well as contract termination costs. Restructuring charges are reflected separately as "Restructuring charges, net" in the Condensed Consolidated Statements of Operations. A summary of the actions we have taken during the three and nine months ended September 26, 2015 and September 27, 2014, the purposes of which were to improve operating efficiency, streamline and simplify our operations and reduce our operating costs, are discussed below.

##### 2015 Restructuring Activities

During the three months ended September 26, 2015, restructuring charges recorded were insignificant. During the nine months ended September 26, 2015, we recorded stock-based compensation expense of approximately \$0.5 million relating to the modification of certain equity-based awards of a full-time employee who was notified of his termination during the fourth quarter of fiscal 2014. The severance terms relating to the modification of his equity-based awards were finalized during the first quarter of fiscal 2015.

##### 2014 Restructuring Activities

On January 27, 2014, we announced a global organizational restructuring and cost reduction plan. As part of the plan, we eliminated 52 full-time employees. In addition, we reduced our temporary workforce by 9 positions. We recorded \$2.0 million of restructuring charges during the first quarter of fiscal 2014, which was comprised of \$1.4 million in severance and related benefits and \$0.6 million in impairment charges for certain equipment that would no longer be utilized. During the three months ended June 28, 2014, we eliminated an additional 2 full-time employees and recorded \$59 thousand in severance charges. During the three months ended September 27, 2014, we eliminated an additional full-time position and recorded \$28 thousand in severance charges. The activities comprising these restructuring activities and the related cash payments were substantially completed and paid by September 27, 2014.

The activities in the restructuring accrual for the nine months ended September 26, 2015 were as follows (in thousands):

|                                     | Employee<br>Severance<br>and Benefits | Stock-based<br>Compensation | Total  |
|-------------------------------------|---------------------------------------|-----------------------------|--------|
| Accrual at December 27, 2014        | \$584                                 | \$ —                        | \$584  |
| Restructuring charges               | 59                                    | 500                         | 559    |
| Cash payments                       | (618                                  | ) —                         | (618   |
| Adjustment to restructuring charges | 3                                     | —                           | 3      |
| Non-cash settlement                 | —                                     | (500                        | ) (500 |
| Accrual at September 26, 2015       | \$28                                  | \$ —                        | \$28   |

The activities in the restructuring accrual for the nine months ended September 27, 2014 were as follows (in thousands):

|                               | Employee<br>Severance<br>and Benefits | Property and<br>Equipment<br>Impairment | Total  |
|-------------------------------|---------------------------------------|---|--------|
| Accrual at December 28, 2013  | \$138                                 | \$—                                     | \$138  |
| Restructuring charges         | 1,484                                 | 600                                     | 2,084  |
| Cash payments                 | (1,592                                | ) —                                     | (1,592 |
| Asset impairments             | —                                     | (600                                    | ) (600 |
| Non-cash settlements          | (2                                    | ) —                                     | (2     |
| Accrual at September 27, 2014 | \$28                                  | \$—                                     | \$28   |

#### Note 5 — Fair Value

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

We measure and report certain assets and liabilities at fair value on a recurring basis, including money market funds, U.S. Treasury securities, agency securities and foreign currency derivatives (see Note 17 to the Condensed Consolidated Financial Statements - Derivative Financial Instruments, for a discussion of fair value of foreign currency derivatives).

Assets measured at fair value on a recurring basis as of September 26, 2015 were as follows (in thousands):

|                             | Level 1  | Level 2  | Total     |
|-----------------------------|----------|----------|-----------|
| Assets:                     |          |          |           |
| Cash equivalents            |          |          |           |
| Money market funds          | \$81,173 | \$—      | \$81,173  |
| Agency securities (Federal) | —        | 1,500    | 1,500     |
| Marketable securities       |          |          |           |
| U.S. Treasuries             | —        | 19,409   | 19,409    |
| Agency securities (Federal) | —        | 22,245   | 22,245    |
| Total                       | \$81,173 | \$43,154 | \$124,327 |

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Assets measured at fair value on a recurring basis as of December 27, 2014 was as follows (in thousands):

|                             | Level 1   | Level 2   | Total      |
|-----------------------------|-----------|-----------|------------|
| Assets:                     |           |           |            |
| Cash equivalents            |           |           |            |
| Money market funds          | \$ 65,303 | \$—       | \$ 65,303  |
| Marketable securities       |           |           |            |
| U.S. Treasuries             | —         | 42,395    | 42,395     |
| Agency securities (Federal) | —         | 7,502     | 7,502      |
| Total                       | \$ 65,303 | \$ 49,897 | \$ 115,200 |

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

We did not have any transfers of assets measured at fair value on a recurring basis to or from Level 1 and Level 2 during each of the three and nine months ended September 26, 2015 and September 27, 2014.

Assets Measured at Fair Value on a Non-Recurring Basis

We measure and report goodwill and intangible assets at fair value on a non-recurring basis if we determine these assets to be impaired. Refer to Note 3 to the Condensed Consolidated Financial Statements-Goodwill and Intangible Assets, for further details. There were no assets measured at fair value on a nonrecurring basis during the three and nine months ended September 26, 2015 and September 27, 2014.

Note 6 — Marketable Securities

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

Marketable securities at September 26, 2015 consisted of the following (in thousands):

|                             | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair Value |
|-----------------------------|-------------------|------------------------------|-------------------------------|------------|
| U.S. Treasuries             | \$ 19,396         | \$ 13                        | \$—                           | \$ 19,409  |
| Agency securities (Federal) | 22,245            | —                            | —                             | 22,245     |
|                             | \$ 41,641         | \$ 13                        | \$—                           | \$ 41,654  |

Marketable securities at December 27, 2014 consisted of the following (in thousands):

Fair Value



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|                             | Amortized<br>Cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses |            |
|-----------------------------|-------------------|------------------------------|-------------------------------|------------|
| U.S. Treasuries             | \$42,386          | \$ 13                        | \$(4                          | ) \$42,395 |
| Agency securities (Federal) | 7,502             | —                            | —                             | 7,502      |
|                             | \$49,888          | \$ 13                        | \$(4                          | ) \$49,897 |

The marketable securities with gross unrealized losses have been in a loss position for less than twelve months as of September 26, 2015 and December 27, 2014, respectively.

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

Contractual maturities of marketable securities as of September 26, 2015 were as follows (in thousands):

|                                  | Amortized<br>Cost | Fair Value |
|----------------------------------|-------------------|------------|
| Due in one year or less          | \$41,641          | \$41,654   |
| Due after one year to five years | —                 | —          |
|                                  | \$41,641          | \$41,654   |

There were no realized gains and losses on sales and maturities of marketable securities during the three and nine months ended September 26, 2015 and September 27, 2014, respectively.

#### Note 7 — Allowance for Doubtful Accounts

A reconciliation of the changes in our allowance for doubtful accounts receivable for the nine months ended September 26, 2015 and September 27, 2014, respectively, is as follows (in thousands):

|                                | September 26,<br>2015 | September 27,<br>2014 |
|--------------------------------|-----------------------|-----------------------|
| Balance at beginning of period | \$ 266                | \$ 265                |
| Additions                      | —                     | 5                     |
| Reductions                     | (11                   | ) (4                  |
| Balance at end of period       | \$ 255                | \$ 266                |

#### Note 8 — Inventories

Inventories consisted of the following (in thousands):

|                  | September 26,<br>2015 | December 27,<br>2014 |
|------------------|-----------------------|----------------------|
| Raw materials    | \$ 12,283             | \$ 10,646            |
| Work-in-progress | 13,029                | 12,813               |
| Finished goods   | 1,688                 | 2,089                |
|                  | \$ 27,000             | \$ 25,548            |

#### Note 9 — Warranty

A reconciliation of the changes in our warranty liability for the nine months ended September 26, 2015 and September 27, 2014, respectively, is as follows (in thousands):

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|                                | September 26,<br>2015 | September 27,<br>2014 |
|--------------------------------|-----------------------|-----------------------|
| Balance at beginning of period | \$ 1,592              | \$ 691                |
| Accruals                       | 1,855                 | 1,932                 |
| Settlements                    | (2,284                | ) (1,594              |
| Balance at the end of period   | \$ 1,163              | \$ 1,029              |

#### Note 10 — Long-lived Assets

##### Impairment of long-lived assets

During the nine months ended September 26, 2015, long-lived asset impairment charges recorded were insignificant. During the nine months ended September 27, 2014, we recorded \$0.8 million of impairments related to manufacturing assets we no longer utilized. These charges were included in "Impairment of long-lived assets" in the Condensed Consolidated Statements of Operations in their respective periods.

During the three months ended September 26, 2015, we ceased to use fully depreciated assets with an acquired cost of \$0.2 million.

##### Long-lived Assets

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

|   | September 26,<br>2015 | December 27,<br>2014 |
|---|-----------------------|----------------------|
| Machinery and equipment                         | \$ 149,948            | \$ 145,995           |
| Computer equipment and software                 | 28,838                | 28,953               |
| Furniture and fixtures                          | 5,396                 | 5,402                |
| Leasehold improvements                          | 67,090                | 66,821               |
| Sub total                                       | 251,272               | 247,171              |
| Less: accumulated depreciation and amortization | (230,433              | ) (224,135           |
| Net long-lived assets                           | 20,839                | 23,036               |
| Construction-in-progress                        | 2,982                 | 2,462                |
| Total   | \$ 23,821             | \$ 25,498            |

##### Assets held for sale

There were no assets held for sale as of September 26, 2015. During the nine months ended September 27, 2014, we reclassified \$0.6 million of building and \$0.5 million of machinery and equipment from "Property, plant and equipment, net" to "Prepaid expenses and other current assets" in our balance sheet as these assets were identified as held for sale. The sale of the building closed during the third quarter of fiscal 2014 and we recorded a gain of \$0.2 million on the sale during the third quarter of fiscal 2014.

Refer to Note 3 to the Condensed Consolidated Financial Statements - Goodwill and Intangible Assets for further details relating to our intangible long-lived assets.

#### Note 11 — Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss includes foreign currency translation adjustments and unrealized losses on available-for-sale securities, net of tax, the impact of which has been excluded from earnings and reflected as components of stockholders' equity as shown below (in thousands):

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|   | September 26,<br>2015 | December 27,<br>2014 |
|---|-----------------------|----------------------|
| Unrealized loss on marketable securities, net of tax of \$428 at September 26, 2015 and December 27, 2014, respectively | \$ (415 )             | \$ (419 )            |
| Cumulative translation adjustments  | (1,751 )              | (1,342 )             |
| Accumulated other comprehensive loss  | \$ (2,166 )           | \$ (1,761 )          |

## Note 12 — Stockholders' Equity

### Common Stock Repurchase Program

On April 16, 2015, our Board of Directors authorized a program to repurchase up to \$25.0 million of outstanding common stock. Under the authorized stock repurchase program, we may repurchase shares from time-to-time on the open market. The pace of repurchase activity will depend on levels of cash generation, current stock price and other factors. The stock repurchase program was announced on April 16, 2015 and expires on April 15, 2016. The program may be modified or discontinued at any time. During the three months ended September 26, 2015, under this repurchase authorization, we repurchased and retired 472,800 shares of common stock for approximately \$3.5 million. During the nine months ended September 26, 2015, under this repurchase authorization, we repurchased 873,162 shares of common stock for approximately \$7.0 million.

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

### Restricted Stock Units

Restricted stock unit (RSU) activity under our equity incentive plan during the nine months ended September 26, 2015 is set forth below:

|  | Units        | Weighted<br>Average<br>Grant Date<br>Fair Value |
|--|--------------|---|
| Restricted stock units at December 27, 2014  | 3,250,046    | \$ 6.07   |
| Awards granted                               | 1,507,750    | 8.66  |
| Awards vested                                | (1,924,849 ) | 6.04  |
| Awards canceled                              | (169,019 )   | 6.57  |
| Restricted stock units at September 26, 2015 | 2,663,928    | \$ 7.52   |

On May 28, 2015, we issued 195,000 RSUs to seven senior executives of our company that will vest based on certain market performance criteria. The performance criteria are based on a metric called our Total Shareholder Return (TSR) for the period from April 1, 2015 to March 31, 2017 relative to the TSR of the companies identified as being part of the S&P Semiconductor Select Industry Index (FormFactor peer companies), as of April 1, 2015. The total stock-based compensation cost of approximately \$1.5 million will be recognized ratably over the requisite service period.

On May 5, 2014, we issued 350,000 RSUs to seven senior executives of our company that will vest based on certain market performance criteria. The performance criteria are based on our TSR for the period from April 1, 2014 to March 31, 2016 relative to the TSR of the companies identified as being part of the S&P Semiconductor Select Industry Index (FormFactor peer companies), as of April 1, 2014. The total stock-based compensation cost of approximately \$1.8 million will be recognized ratably over the requisite service period.

On May 6, 2013, we issued 355,000 RSUs to seven senior executives and one non-executive of our company that would vest based on certain market performance criteria. The performance criteria were based on our TSR for the period from April 1, 2013 to March 31, 2015 relative to the TSR of the companies identified as being part of the S&P Semiconductor Select Industry Index (FormFactor peer companies), as of April 1, 2013. On April 8, 2015, upon the review of the market performance criteria, our Compensation Committee certified a total earn out of 443,750 RSUs which immediately vested as of that date.

The total fair value of RSUs vested during the three months ended September 26, 2015 was insignificant. The total fair value of RSUs vested during the nine months ended September 26, 2015 was \$17.5 million. The total fair value of RSUs vested during the three and nine months ended September 27, 2014 was \$0.2 million and \$7.3 million, respectively.

### Stock Options

During the nine months ended September 26, 2015, we granted 450,000 stock options to our Chief Executive Officer with a grant-date fair value of approximately \$1.7 million which will be recognized as stock compensation expense ratably over the service period. The following weighted average assumptions were used in the estimated grant-date fair value calculations using the Black-Scholes option pricing model:

#### Stock Options:

|                          |      |   |
|--------------------------|------|---|
| Dividend yield           | —    | % |
| Expected volatility      | 47.5 | % |
| Risk-free interest rate  | 1.57 | % |
| Expected term (in years) | 5.52 |   |

During the nine months ended September 27, 2014, we did not grant any stock options.

### Note 13 — Stock-Based Compensation

We account for all stock-based compensation to employees and directors, including grants of RSUs and stock options, as stock-based compensation costs based on the fair value measured as of the date of grant. These costs are recognized as an expense in the Condensed Consolidated Statements of Operations over the requisite service period.

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

|  | Three Months Ended |               | Nine Months Ended |               |
|--|--------------------|---------------|-------------------|---------------|
|  | September 26,      | September 27, | September 26,     | September 27, |
|  | 2015               | 2014          | 2015              | 2014          |
| Stock-based compensation included in:      |                    |               |                   |               |
| Cost of revenues                           | \$ 756             | \$ 700        | \$ 1,941          | \$ 1,855      |
| Research and development                   | 973                | 1,077         | 2,544             | 2,638         |
| Selling, general and administrative        | 1,371              | 2,157         | 4,030             | 5,530         |
| Total stock-based compensation             | 3,100              | 3,934         | 8,515             | 10,023        |
| Tax effect of stock-based compensation     | —                  | —             | —                 | —             |
| Total stock-based compensation, net of tax | \$ 3,100           | \$ 3,934      | \$ 8,515          | \$ 10,023     |

During the nine months ended September 26, 2015, we recorded stock-based compensation expense of approximately \$0.5 million relating to a full-time employee who was impacted by our restructuring activities. Hence, we classified this stock-based compensation expense as a restructuring expense. The table above does not include this expense. Refer to Note 4 to the Condensed Consolidated Financial Statements - Restructuring Charges for further details.

### Employee Stock Purchase Plan



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Under our 2012 Employee Stock Purchase Plan ("ESPP"), the offering periods are 12 months commencing on February 1 of each calendar year and ending on January 31 of the subsequent calendar year, and a six month fixed offering period commencing on August 1 of each calendar year and ending on January 31 of the subsequent calendar year. The 12 month offering period consists of two six month purchase periods and the six month offering period consists of one six month purchase period. The price of the common stock purchased is 85% of the lesser of the fair market value of the common stock on the first day of the applicable offering period or the last day of each purchase period.

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During the three months ended September 26, 2015 and September 27, 2014, we issued 262,788 and 265,467 ESPP shares, respectively. During the nine months ended September 26, 2015 and September 27, 2014, we issued 565,493 and 586,386 ESPP shares, respectively.

The following weighted-average assumptions were used in estimating the fair value of employees' purchase rights under our approved employee stock purchase plans:

|                          | Three Months Ended |                    | Nine Months Ended  |                    |   |
|--------------------------|--------------------|--------------------|--------------------|--------------------|---|
|                          | September 26, 2015 | September 27, 2014 | September 26, 2015 | September 27, 2014 |   |
| ESPP:                    |                    |                    |                    |                    |   |
| Dividend yield           | —                  | % —                | % —                | % —                | % |
| Expected volatility      | 52.2               | % 41.6             | % 52.1             | % 41.9             | % |
| Risk-free interest rate  | 0.14               | % 0.09             | % 0.10             | % 0.09             | % |
| Expected term (in years) | 0.81               | 0.81               | 0.66               | 0.66               |   |

#### Unrecognized Compensation Costs

At September 26, 2015, the unrecognized stock-based compensation, adjusted for estimated forfeitures, was as follows (in thousands):

|   | Unrecognized Expense | Average Expected Recognition Period in years |
|---|----------------------|--|
| Stock options                                       | \$ 1,457             | 3.36   |
| Restricted stock units                              | 14,309               | 2.09   |
| Employee stock purchase plan                        | 463                  | 0.35   |
| Total unrecognized stock-based compensation expense | \$ 16,229            |  |

#### Note 14 — Net Loss per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding for the period. Diluted net loss per share for the three and nine months ended September 26, 2015 and September 27, 2014, respectively, was computed by dividing net loss by the weighted-average number of common shares outstanding for the period as the inclusion of any common stock equivalents would have been anti-dilutive.

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

|  | Three Months Ended |                    | Nine Months Ended  |                    |
|--|--------------------|--------------------|--------------------|--------------------|
|  | September 26, 2015 | September 27, 2014 | September 26, 2015 | September 27, 2014 |
| Numerator:   |                    |                    |                    |                    |
| Net loss used in computing basic and diluted net loss per share    | \$ (2,525 )        | \$ (277 )          | \$ (904 )          | \$ (17,314 )       |
| Denominator:   |                    |                    |                    |                    |
| Weighted-average shares used in computing basic net loss per share | 58,209             | 56,297             | 57,757             | 55,720             |

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|  |        |        |        |        |
|--|--------|--------|--------|--------|
| Add potentially dilutive securities  | —      | —      | —      | —      |
| Weighted-average shares used in computing basic and diluted net loss per share | 58,209 | 56,297 | 57,757 | 55,720 |

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

|                                       | Three Months Ended |                    | Nine Months Ended  |                    |
|---------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                       | September 26, 2015 | September 27, 2014 | September 26, 2015 | September 27, 2014 |
| Options to purchase common stock      | 2,710              | 2,675              | 2,380              | 2,981              |
| Restricted stock units                | 1,717              | —                  | 1,550              | 1                  |
| Employee stock purchase plan          | —                  | 20                 | 30                 | 1                  |
| Total potentially dilutive securities | 4,427              | 2,695              | 3,960              | 2,983              |

#### Note 15 — Income Taxes

We recorded an income tax provision of \$0.2 million and \$0.4 million for the three and nine months ended September 26, 2015 and \$0.1 million and \$0.4 million for the three and nine months ended September 27, 2014, respectively. Income tax provisions reflect the tax provision on our operations in the foreign and U.S jurisdictions offset by tax benefit from lapsing of statute of limitations in foreign jurisdictions. We continue to maintain a valuation allowance for our U.S. Federal and State deferred tax assets.

#### Note 16 — Commitments and Contingencies

##### Contractual and purchase obligations

We lease facilities under non-cancellable operating leases with various expiration dates through 2021. The facilities generally require us to pay property taxes, insurance and maintenance costs. Further, several lease agreements contain rent escalation clauses or rent holidays. For purposes of recognizing minimum rental expenses on a straight-line basis over the terms of the leases, we use the date of initial possession to begin amortization. We have the option to extend or renew most of our leases, which may increase the future minimum lease commitments.

Purchase obligations are primarily for purchases of inventory and manufacturing related service contracts. Purchase obligations are defined as agreements that are enforceable and legally binding and that specify all significant terms, including: fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Timing of payments and actual amounts paid may be different depending on the time of receipt of goods or services or changes to agreed-upon amounts for some obligations.

Our lease and purchase obligations have not materially changed as of September 26, 2015 from those disclosed in our Annual Report on Form 10-K for the year ended December 27, 2014.

##### Environmental Matters

We are subject to U.S. Federal, State and local, and foreign governmental laws and regulations relating to the protection of the environment, including those governing the discharge of pollutants into the air and water, the management and disposal of hazardous substances and wastes, the clean-up of contaminated sites and the maintenance of a safe workplace. We believe that we comply in all material respects with the environmental laws and regulations that apply to us, including those of the California Department of Toxic Substances Control, the Bay Area Air Quality Management District, the City of Livermore Water Resources Division, County of Santa Clara Department of Environmental Health, County of San Diego Hazardous Materials Division and Encino Water District, and the California Division of Occupational Safety and Health. We did not receive any notices of violations of environmental laws and regulations during the nine months ended September 26, 2015, or in our fiscal 2014. We do not believe that any loss from existing environmental remediation liabilities would have a material impact on our financial condition. While we believe that we are in compliance in all material respects with the environmental laws and regulations that apply to us, in the future, we may receive environmental violation notices, and if received, final resolution of the

violations identified by these notices could harm our operations, which may adversely impact our operating results and cash flows. New laws and regulations, amended enforcement practices around existing laws and regulations, the discovery of previously unknown contamination at our or others' sites or the imposition of new cleanup requirements could also harm our operations, thereby adversely impacting our operating results and cash flows.

#### Indemnification Arrangements

We have entered, and may from time to time in the ordinary course of our business enter, into contractual arrangements with third parties that include indemnification obligations. Under these contractual arrangements, we have agreed to defend, indemnify and/or hold the third party harmless from and against certain liabilities. These arrangements include indemnities in favor of customers in the event that our products or services infringe a third party's intellectual property or cause property or other damages and indemnities in favor of our lessors in connection with facility leasehold liabilities that we may cause. In addition, we have entered into indemnification agreements with our directors and certain of our officers, and our bylaws contain indemnification obligations in favor of our directors, officers and agents. These indemnity arrangements may limit the type of the claim, the total amount that we can be required to be paid in connection with the indemnification obligation and the time within which an indemnification claim can be made. The duration of the indemnification obligation may vary, and for most arrangements, survives the agreement term and is indefinite. We believe that substantially all of our indemnity arrangements provide either for limitations on the maximum potential future payments we could be obligated to make, or for limitations on the types of claims and damages we could be obligated to indemnify, or both. However, it is not possible to determine or reasonably estimate the maximum potential amount of future payments under these indemnification obligations due to the varying terms of such obligations, a lack of history of prior indemnification claims, the unique facts and circumstances involved in each particular contractual arrangement and in each potential future claim for indemnification, and the contingency of any potential liabilities upon the occurrence of events that are not reasonably determinable. We have not had any material requests for indemnification under these arrangements. Our management believes that any liability for these indemnity arrangements would not be material to our accompanying consolidated financial statements. We have not recorded any liabilities for these indemnification arrangements on our consolidated balance sheet as of September 26, 2015.

#### Legal Matters

From time to time, we may be subject to legal proceedings and claims in the ordinary course of business. For the nine months ended September 26, 2015, we were not involved in any material legal proceedings. We identify below in "Other Litigation", a proceeding filed in fiscal 2013, which, if not resolved amicably, either (i) includes allegations that could potentially result in a material legal proceeding, or (ii) the cost to defend the allegations through trial could be material. In the future we may become a party to additional legal proceedings that may require us to spend significant resources, including proceedings designed to protect our intellectual property rights. Litigation can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict, and the costs incurred in litigation can be substantial, regardless of outcome.

#### Customs and Trade Matters

From time to time, we receive communications from certain jurisdictions regarding customs and indirect tax matters such as customs duties and value added taxes. For the nine months ended September 26, 2015, we did not receive any communications from jurisdictions regarding any material customs duties or indirect tax matters.

#### Intellectual Property Litigation

In the ordinary course of business, the Company has been, currently is, and may in the future be, involved in litigation relating to intellectual property, as well as third party initiated patent office proceedings in the United States and foreign patent offices.

In March 2014, we filed a lawsuit against MarTek, Inc., a company headquartered in Tempe, Arizona ("MarTek"), asserting breach of contract, copyright infringement and related claims arising out of a licensing agreement we entered into with MarTek for the use by MarTek of certain intellectual property assets (the "IP") relating to probes that we acquired from the bankruptcy of Electroglas, Inc. MarTek asserted counterclaims against us for breach of contract and related claims regarding that license.

On July 13, 2015 (the "closing date"), we entered into an agreement with MarTek under which the parties agreed to dismiss the pending litigation and release each other from any and all claims relating to the license agreement or the IP through the closing date. As part of the agreement, we agreed to sell the IP to MarTek for \$2 million, of which \$1.2 million was received on July 17, 2015 and the remaining \$0.8 million is in the form of a promissory note secured by the IP and scheduled to be repaid by MarTek in two equal tranches on the first and second anniversary of the closing date. During the three months ended September 26, 2015, we recognized a net gain of approximately \$1.0 million (which was classified in our Condensed Consolidated Statement of Operations under Other Income (Expense), net) from the agreement proceeds received on July 17, 2015.

## Other Litigation

In August 2013, a former employee (“Plaintiff”) filed a class action lawsuit against the Company in the Superior Court of California, alleging violations of California’s wage and hour laws and unfair business practices on behalf of himself and all other similarly situated current and former employees at the Company’s Livermore facilities from August 21, 2009, to the present. The Plaintiff’s motion to certify a class is pending. Procedurally, the case is still in the early stages of litigation. The Company denies the allegations made by the Plaintiff, and believes it has significant defenses to the claims made in the lawsuit. If the matter is not settled, the Company could incur material attorneys’ fees in defending the lawsuit.

## Note 17 — Derivative Financial Instruments

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

The following table provides information about our foreign currency forward contracts outstanding as of September 26, 2015 (in thousands):

| Currency  | Contract Position | Contract Amount (Local Currency) | Contract Amount (U.S. Dollars) |
|---|-------------------|----------------------------------|--------------------------------|
| Japanese Yen  | Sell              | 2,716,297                        | \$22,471                       |
| Taiwan Dollar   | Buy               | (40,006                          | ) (1,209 )                     |
| Korean Won  | Buy               | (687,168                         | ) (581 )                       |
| Total USD notional amount of outstanding foreign exchange contracts |                   |                                  | \$20,681                       |

The contracts were entered into on September 25, 2015 and matured on October 23, 2015. Our foreign currency contracts are classified within Level 2 of the fair value hierarchy as they are valued using pricing models that utilize observable market inputs. There was no change in the value of these contracts as of September 26, 2015. Additionally, no gains or losses relating to the outstanding derivative contracts were recorded in the three and nine months ended September 26, 2015.

The location and amount of losses and gains related to non-designated derivative instruments that matured in the three and nine months ended September 26, 2015 and September 27, 2014 in the Condensed Consolidated Statements of Operations are as follows (in thousands):

| Derivatives Not Designated as Hedging Instruments | Location of Loss (Gain) Recognized on Derivatives | Amount of Loss (Gain) Recognized on Derivatives |                    |                    |                    |
|---|---|---|--------------------|--------------------|--------------------|
|   |   | Three Months Ended                              |                    | Nine Months Ended  |                    |
|   |   | September 26, 2015                              | September 27, 2014 | September 26, 2015 | September 27, 2014 |
|   |   |   |                    |                    |                    |



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|                                    |                             |           |        |           |        |
|------------------------------------|-----------------------------|-----------|--------|-----------|--------|
| Foreign exchange forward contracts | Other income (expense), net | \$ (902 ) | \$ 740 | \$ (217 ) | \$ 465 |
|------------------------------------|-----------------------------|-----------|--------|-----------|--------|

Note 18 — Business Interruption Insurance Claim Recovery

During the nine months ended September 26, 2015, we received approximately \$1.5 million as a result of a payment from our insurer arising from a business interruption insurance claim related to a factory fire at a customer during the second half of fiscal 2013. We recorded this cash receipt within “Other income (expense), net” in our Condensed Consolidated Statements of Operations.

## 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 and uncertainties. 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 on Form 10-Q are based upon information available to us as of the filing date of this Quarterly Report on Form 10-Q. You should not place undue reliance on these forward-looking statements. We have no obligation to update any of these statements. These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from those expressed or implied by these statements. These factors include the matters discussed in the section titled "Risk Factors" in our Annual Report on Form 10-K for the year ended December 27, 2014 and elsewhere in this Quarterly Report on Form 10-Q. You should carefully consider the numerous risks and uncertainties described under these sections.

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

### Overview

We design, develop, manufacture, sell and support advanced semiconductor probe card products, and are the largest supplier worldwide of those products. Semiconductor manufacturers use our probe cards to perform wafer test (also known as wafer sort), which is the testing of the semiconductor die, or chips, while those die are still constituted on the semiconductor wafer. Wafer test enables semiconductor manufacturers to determine whether chips will meet specifications and be saleable once the wafer is diced, and the die are singulated and individually packaged. Given the relatively high per-die costs of singulation and packaging processes, and the fact that semiconductor process yields are typically less than 100%, meaning that some of the die on a wafer are expected to be defective, there is often a compelling economic reason to perform wafer test. Probe cards are a critical element in enabling that wafer test process.

Historically, sales for probe cards for testing Dynamic Random Access Memory, or DRAM, devices have made up the majority of our revenues. In October 2012, we completed the acquisition of Astria Semiconductor Holdings, Inc., including its subsidiary Micro-Probe Incorporated (together "MicroProbe"). The majority of MicroProbe's revenue was made up of sales of probe cards for testing System-on-Chip, or SoC, devices.

We generated net loss of \$(0.9) million in the first nine months of fiscal 2015 as compared to a net loss of \$(17.3) million in the first nine months of fiscal 2014. The decrease in net loss is primarily attributable to our increased revenues and our ongoing cost reduction efforts.

Our cash, cash equivalents and marketable securities and restricted cash totaled approximately \$184.3 million as of September 26, 2015, as compared to approximately \$164.3 million at December 27, 2014. The increase in our cash,

cash equivalents and marketable securities balances was primarily due to improved operating results, net of investments in working capital to grow revenues. We generated \$5.1 million, \$7.1 million, and \$7.8 million of cash in the third, second and first fiscal quarters of 2015, respectively, as compared to generating \$5.3 million, \$5.0 million and using \$(7.1) million of cash in the third, second and first fiscal quarters of 2014, respectively. We believe that we will be able to satisfy our working capital requirements for at least the next twelve months with the liquidity provided by our existing cash, cash equivalents and marketable securities. If we are unsuccessful in maintaining or growing our revenues, or maintaining or reducing our cost structure in an industry downturn, or increasing our available cash through financing, our cash, cash equivalents and/or marketable securities could decline in future fiscal years.

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

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

**Cost of Revenues.** Cost of revenues consists primarily of manufacturing materials, payroll, shipping and handling costs, manufacturing-related overhead and amortization of certain intangible assets. Our manufacturing operations rely upon a limited number of suppliers to provide key components and materials for our products, some of which are a sole source. We order materials and supplies based on backlog and forecasted customer orders. Tooling and setup costs related to changing manufacturing lots at our suppliers are also included in the cost of revenues. We expense all warranty costs, inventory provisions and amortization of certain intangible assets as cost of revenues.

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

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

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

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

**Impairment of Long-Lived Assets.** Asset impairment charges include charges associated with the write-down of assets that have no future expected benefit or for assets that have been determined to be impaired as well as adjustments to the carrying amount of our assets held for sale.

## Results of Operations

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



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|                                     | Three Months Ended |                    | Nine Months Ended  |                    |
|-------------------------------------|--------------------|--------------------|--------------------|--------------------|
|                                     | September 26, 2015 | September 27, 2014 | September 26, 2015 | September 27, 2014 |
| Revenues                            | 100.0              | % 100.0            | % 100.0            | % 100.0            |
| Cost of revenues                    | 72.0               | 67.3               | 69.3               | 71.4               |
| Gross profit                        | 28.0               | 32.7               | 30.7               | 28.6               |
| Operating expenses:                 |                    |                    |                    |                    |
| Research and development            | 16.1               | 15.2               | 15.6               | 16.2               |
| Selling, general and administrative | 16.9               | 18.0               | 16.3               | 19.6               |
| Restructuring charges, net          | 0.1                | —                  | 0.3                | 1.1                |
| Impairment of long-lived assets     | —                  | 0.1                | —                  | 0.4                |
| Total operating expenses            | 33.1               | 33.3               | 32.2               | 37.3               |
| Operating loss                      | (5.1)              | ) (0.7)            | ) (1.5)            | ) (8.7)            |
| Interest income, net                | 0.1                | 0.1                | 0.1                | 0.1                |
| Other income (expense), net         | 1.5                | 0.3                | 1.2                | —                  |
| Loss before income taxes            | (3.5)              | ) (0.3)            | ) (0.2)            | ) (8.6)            |
| Provision for income taxes          | 0.3                | 0.1                | 0.2                | 0.2                |
| Net loss                            | (3.8)              | )% (0.4)           | )% (0.4)           | )% (8.8)           |

Three and nine months ended September 26, 2015 and September 27, 2014:

Revenues

Revenues by Market

|                                    | Three Months Ended |                    |          | Nine Months Ended  |                    |          |
|------------------------------------|--------------------|--------------------|----------|--------------------|--------------------|----------|
|                                    | September 26, 2015 | September 27, 2014 | % Change | September 26, 2015 | September 27, 2014 | % Change |
| (In thousands, except percentages) |                    |                    |          |                    |                    |          |
| SoC                                | \$36,479           | \$39,386           | (7.4)%   | \$104,461          | \$105,653          | (1.1)%   |
| DRAM                               | 27,443             | 31,383             | (12.6)%  | 97,268             | 79,985             | 21.6%    |
| Flash                              | 1,940              | 3,164              | (38.7)%  | 8,847              | 11,607             | (23.8)%  |
| Total revenues                     | \$65,862           | \$73,933           | (10.9)%  | \$210,576          | \$197,245          | 6.8%     |

Revenues for the three months ended September 26, 2015 decreased 11%, or approximately \$8.1 million, as compared to the corresponding period in the prior year. Revenues for the nine months ended September 26, 2015 increased 7%, or approximately \$13.3 million, as compared to the corresponding period in the prior year. For the three months ended September 26, 2015, our revenue decreased 7% in our SoC products, 13% in our DRAM products and 39% in our Flash memory products, as compared to the corresponding period in the prior year. For the nine months ended September 26, 2015, our revenue decreased 1% in our SoC products, increased 22% in our DRAM products and decreased 24% in our Flash memory products, as compared to the corresponding period in the prior year.

The decrease in our DRAM revenues for the three months ended September 26, 2015 was primarily due to reduced commodity DRAM market demand. The increase in DRAM revenues for the nine months ended September 26, 2015 was primarily driven by market share increases at a major South Korean memory producer, based on the adoption of our SmartMatrix product.

The decrease in SoC revenue for the three and nine months ended September 26, 2015 was primarily due to reduced mobile processor and gaming system processor demand.

The decrease in Flash memory revenue for the three and nine months ended September 26, 2015 was primarily due to a combination of a weakening NOR Flash memory market and pricing pressure for our NAND Flash products partially offset in the nine month period by increased demand for our TouchMatrix product to test NAND Flash devices at a South Korean memory producer.

### Revenues by Geographic Region

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

|                                    | Three Months Ended |              |                    |              | Nine Months Ended  |              |                    |              |
|------------------------------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|--------------------|--------------|
|                                    | September 26, 2015 | % of Revenue | September 27, 2014 | % of Revenue | September 26, 2015 | % of Revenue | September 27, 2014 | % of Revenue |
| (In thousands, except percentages) |                    |              |                    |              |                    |              |                    |              |
| South Korea                        | \$ 21,134          | 32.1 %       | \$ 14,502          | 19.6 %       | \$ 53,593          | 25.5 %       | \$ 41,784          | 21.2 %       |
| North America                      | 10,142             | 15.4         | 19,569             | 26.5         | 45,994             | 21.8         | 52,406             | 26.6         |
| Taiwan                             | 12,327             | 18.7         | 12,398             | 16.8         | 43,913             | 20.9         | 33,366             | 16.9         |
| Asia-Pacific (1)                   | 8,317              | 12.6         | 12,090             | 16.4         | 26,744             | 12.8         | 26,377             | 13.5         |
| Europe                             | 8,944              | 13.6         | 8,231              | 11.1         | 20,378             | 9.7          | 23,413             | 11.9         |
| Japan                              | 4,998              | 7.6          | 7,143              | 9.7          | 19,954             | 9.5          | 19,899             | 10.1         |
| Total revenues                     | \$ 65,862          | 100.0 %      | \$ 73,933          | 100.0 %      | \$ 210,576         | 100.0 %      | \$ 197,245         | 100.0 %      |

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

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

The change in revenues from our geographical regions for the three and nine months ended September 26, 2015, when compared to the same periods in fiscal 2014, were primarily driven by:

- South Korea revenues increased for both the three and nine month periods driven primarily by a combination of market share increases at a major South Korean customer based on the adoption of our SmartMatrix product and increased SoC product shipments related to mobile processor demand;
- North America revenues decreased for both the three and nine month periods driven primarily by a shift of SoC product shipments for personal computer processors to customers' test facilities in Europe;
- Taiwan revenues increased for the nine month period driven primarily by a combination of increased SoC product shipments and an increase in commodity or personal computer DRAM demand, with revenues relatively flat year over year for the three month period;
- Asia-Pacific revenues decreased for the three month period driven primarily by reduced sales of our SmartMatrix DRAM products in that region. Revenues were relatively flat year over year for the nine month period;
- Japan revenues decreased for both the three and nine months periods driven primarily by lower mobile DRAM demand served by our SmartMatrix product; and



- Europe revenues increased for both the three and nine months periods driven primarily by a shift of SoC product shipments for personal computer processors to customers' test facilities in Europe as opposed to in North America, which was partially offset by reduced mobile processor related product demand.

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

|          | Three Months Ended |                    | Nine Months Ended  |                    |
|----------|--------------------|--------------------|--------------------|--------------------|
|          | September 26, 2015 | September 27, 2014 | September 26, 2015 | September 27, 2014 |
| Samsung  | 23.1               | % 10.8             | % 16.4             | % *                |
| Intel    | 18.1               | 18.9               | 17.9               | 18.3               |
| SK hynix | 15.6               | 15.6               | 15.3               | 18.0               |
| Micron   | *                  | 16.6               | 12.6               | 14.6               |
|          | 56.8               | % 61.9             | % 62.2             | % 50.9             |

\* Less than 10% of revenues.

Gross Profit

|               | Three Months Ended                 |                    | Nine Months Ended  |                    |
|---------------|------------------------------------|--------------------|--------------------|--------------------|
|               | September 26, 2015                 | September 27, 2014 | September 26, 2015 | September 27, 2014 |
|               | (In thousands, except percentages) |                    |                    |                    |
| Gross profit  | \$ 18,455                          | \$ 24,142          | \$ 64,548          | \$ 56,491          |
| % of revenues | 28.0                               | % 32.7             | % 30.7             | % 28.6             |

Gross profit fluctuates with revenue levels, product mix, selling prices, factory loading, and material costs.

For the three months ended September 26, 2015, the amount of gross profit decreased compared to the same period in the prior year primarily due to less favorable product mix, and decreased demand for our products resulting in lower factory utilization.

For the nine months ended September 26, 2015, the amount of gross profit increased compared to the same period in the prior year, primarily due to higher production volume driven by higher sales. Factory utilization, execution and operating efficiency improved. We also increased production yields and reduced obsolete inventory charges and acquisition-related intangible amortization expense.

Our inventory reserve charges increased by \$0.2 million and declined by \$0.7 million for the three and nine months ended September 26, 2015 when compared to the corresponding periods in the prior year. For the three and nine months ended September 26, 2015, the value of previously reserved materials that were used in manufacturing and shipped was \$0.4 million and \$2.0 million, respectively.

Gross profit included stock-based compensation expense of \$0.8 million and \$1.9 million, respectively, for the three and nine months ended September 26, 2015, compared to \$0.7 million and \$1.9 million, respectively, for the three and nine months ended September 27, 2014.

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

Research and Development

| Three Months Ended | Nine Months Ended |
|--------------------|-------------------|
|--------------------|-------------------|

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|                          | September 26,<br>2015              | September 27,<br>2014 | September 26,<br>2015 | September 27,<br>2014 |   |
|--------------------------|------------------------------------|-----------------------|-----------------------|-----------------------|---|
|                          | (In thousands, except percentages) |                       |                       |                       |   |
| Research and development | \$ 10,645                          | \$ 11,198             | \$ 32,947             | \$ 32,019             |   |
| % of revenues            | 16.1                               | % 15.2                | % 15.6                | % 16.2                | % |

Research and development expenses for the three and nine months ended September 26, 2015 decreased by \$0.6 million and increased by \$0.9 million, respectively, compared to the same periods in the prior year.

The decrease in the three months ended September 26, 2015 compared to the same period in the prior year was primarily due to a decrease of \$0.6 million in incentive compensation, \$0.2 million in overall general operating expenses and \$0.1 million in stock compensation expense offset by an increase of \$0.2 million in personnel-related costs and \$0.2 million in project and material costs.

The increase in the nine months ended September 26, 2015 compared to the same period in the prior year was primarily due to an increase of \$1.0 million in project and material costs, \$0.2 million in incentive compensation, \$0.1 million in personnel-related costs and \$0.1 million in travel costs offset by a reduction of \$0.5 million in overall general operating expenses.

Stock-based compensation expense included in research and development expenses was \$1.0 million and \$2.5 million, respectively, for the three and nine months ended September 26, 2015, compared to \$1.1 million and \$2.6 million, respectively, for the three and nine months ended September 27, 2014.

#### Selling, General and Administrative

|                                     | Three Months Ended<br>September 26, 2015 |           | September 27, 2014 |           | Nine Months Ended<br>September 26, 2015 |  | September 27, 2014 |   |
|-------------------------------------|--|-----------|--------------------|-----------|---|--|--------------------|---|
|                                     | (In thousands, except percentages)       |           |                    |           |   |  |                    |   |
| Selling, general and administrative | \$ 11,108                                | \$ 13,309 | \$ 34,373          | \$ 38,754 |   |  |                    |   |
| % of revenues                       | 16.9                                     | % 18.0    | % 16.3             | % 19.6    |   |  |                    | % |

Selling, general and administrative expenses for the three and nine months ended September 26, 2015 decreased by \$2.2 million and \$4.4 million, respectively, compared to the same periods in the prior year.

The decrease in the three months ended September 26, 2015 compared to the same period in the prior year was primarily due to a decrease of \$0.8 million in stock compensation expense, \$0.5 million in personnel-related costs, \$0.5 million in incentive compensation, \$0.3 million in legal expenses and \$0.2 million in travel costs offset by an increase of \$0.3 million in consulting costs to support strategic corporate initiatives.

The decrease in the nine months ended September 26, 2015 compared to the same period in the prior year was primarily due to a decrease of \$1.5 million in stock compensation expense, \$1.1 million in personnel-related costs, \$0.7 million in legal expenses, \$0.7 million in overall general operating expenses, \$0.3 million in payroll taxes, \$0.2 million in incentive compensation, \$0.1 million in travel costs and which was partially offset by an increase of \$0.3 million in consulting costs to support strategic corporate initiatives.

Stock-based compensation expense included within selling, general and administrative expenses was \$1.4 million and \$4.0 million, respectively, for the three and nine months ended September 26, 2015, compared to \$2.2 million and \$5.5 million, respectively, for the three and nine months ended September 27, 2014.

#### Restructuring Charges, net

|  | Three Months Ended<br>September 26, 2015 |  | September 27, 2014 |  | Nine Months Ended<br>September 26, 2015 |  | September 27, 2014 |  |
|--|--|--|--------------------|--|---|--|--------------------|--|
|  |  |  |                    |  |   |  |                    |  |

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|                            | (In thousands, except percentages) |       |        |          |   |  |
|----------------------------|------------------------------------|-------|--------|----------|---|--|
| Restructuring charges, net | \$ 59                              | \$ 28 | \$ 562 | \$ 2,084 |   |  |
| % of revenues              | 0.1                                | % —   | % 0.3  | % 1.1    | % |  |

For the three and nine months ended September 26, 2015, restructuring charges increased by \$31.0 thousand and \$1.5 million, respectively, from the comparable periods of the prior year. Our restructuring activities are discussed below.

## 2015 Restructuring Activities

During the three months ended September 26, 2015, restructuring charges recorded were insignificant. During the nine months ended September 26, 2015, we recorded stock-based compensation expense of approximately \$0.5 million relating to the modification of certain equity-based awards of a full-time employee who was notified of his termination during the fourth quarter of fiscal 2014. The severance terms relating to the modification of his equity-based awards were finalized during the first quarter of fiscal 2015.

## 2014 Restructuring Activities

On January 27, 2014, we announced a global organizational restructuring and cost reduction plan. As part of the plan, we eliminated 52 full-time employees. In addition, we reduced our temporary workforce by 9 positions. We recorded \$2.0 million of restructuring charges during the first quarter of fiscal 2014, which was comprised of \$1.4 million in severance and related benefits and \$0.6 million in impairment charges for certain equipment that would no longer be utilized. During the three months ended June 28, 2014, we eliminated an additional 2 full-time employees and recorded \$59 thousand in severance charges. During the three months ended September 27, 2014, we eliminated an additional full-time position and recorded \$28 thousand in severance charges. The activities comprising these restructuring activities and the related cash payments were substantially completed and paid by September 27, 2014.

## Impairment of Long-lived Assets

|                                 | Three Months Ended                 |               | Nine Months Ended |               |   |
|---------------------------------|------------------------------------|---------------|-------------------|---------------|---|
|                                 | September 26,                      | September 27, | September 26,     | September 27, |   |
|                                 | 2015                               | 2014          | 2015              | 2014          |   |
|                                 | (In thousands, except percentages) |               |                   |               |   |
| Impairment of long-lived assets | \$—                                | \$ 86         | \$ 8              | \$ 829        |   |
| % of revenues                   | —                                  | % 0.1         | % —               | % 0.4         | % |

We test long-lived assets or asset groups for recoverability when events or changes in circumstances indicate that their carrying amounts may not be recoverable. During the nine months ended September 26, 2015, long-lived asset impairment charges recorded were insignificant. During the nine months ended September 27, 2014, we recorded \$0.8 million of impairments related to manufacturing assets we no longer utilized.

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

|                             | Three Months Ended                 |               | Nine Months Ended |               |   |
|-----------------------------|------------------------------------|---------------|-------------------|---------------|---|
|                             | September 26,                      | September 27, | September 26,     | September 27, |   |
|                             | 2015                               | 2014          | 2015              | 2014          |   |
|                             | (In thousands, except percentages) |               |                   |               |   |
| Interest income, net        | \$ 65                              | \$ 75         | \$ 213            | \$ 233        |   |
| % of revenue                | 0.1                                | % 0.1         | % 0.1             | % 0.1         | % |
| Other income (expense), net | \$ 982                             | \$ 228        | \$ 2,584          | \$ 6          |   |
| % of revenues               | 1.5                                | % 0.3         | % 1.2             | % —           | % |

Interest income is primarily earned on our cash, cash equivalents and marketable securities. The decrease in interest income for the three and nine months ended September 26, 2015 as compared with the same periods of the prior year was primarily the result of lower yields. Cash, cash equivalents, restricted cash and marketable securities were \$184.3 million at September 26, 2015 compared to \$154.8 million at September 27, 2014. The weighted-average yield on our

cash, cash equivalents and marketable securities for the three months ended September 26, 2015 and September 27, 2014 was 0.11% and 0.16%, respectively. The weighted-average yield on our cash, cash equivalents and marketable securities for the nine months ended September 26, 2015 and September 27, 2014 was 0.12% and 0.17%, respectively.

Other income (expense), net is comprised primarily of foreign currency impact and various other gains and losses. The increase in other income (expense), net during the three months ended September 26, 2015 was primarily due to approximately \$1.0 million net gain recognized from the sale of intellectual property to MarTek - see Note 16 to the Condensed Consolidated

Financial Statements - Commitments and Contingencies, for further details. The increase in other income (expense), net was partially offset by approximately \$0.3 million in foreign currency losses and various other gains and losses. The increase in other income (expense), net for the nine months ended September 26, 2015 as compared with the same period of the prior year was primarily due to the \$1.0 million net gain recognized from the sale of intellectual property to MarTek and approximately \$1.5 million cash received as a result of a payment from our insurer arising from a business interruption insurance claim related to a factory fire at a customer during the second half of fiscal 2013.

#### Provision for Income Taxes

|                            | Three Months Ended                 |               | Nine Months Ended |               |    |
|----------------------------|------------------------------------|---------------|-------------------|---------------|----|
|                            | September 26,                      | September 27, | September 26,     | September 27, |    |
|                            | 2015                               | 2014          | 2015              | 2014          |    |
|                            | (In thousands, except percentages) |               |                   |               |    |
| Provision for income taxes | \$ 215                             | \$ 101        | \$ 359            | \$ 358        |    |
| Effective tax rate         | (9.3                               | )% (57.4      | )% (65.9          | )% (2.1       | )% |

We recorded an income tax provision of \$0.2 million and \$0.4 million for the three and nine months ended September 26, 2015 and \$0.1 million and \$0.4 million for the three and nine months ended September 27, 2014, respectively. Income tax provisions reflect the tax provision on our operations in the foreign and U.S jurisdictions offset by tax benefit from lapsing of statute of limitations in foreign jurisdictions. We continue to maintain a valuation allowance for our U.S. Federal and State deferred tax assets.

#### Liquidity and Capital Resources

**Capital Resources:** Our working capital was \$212.0 million at September 26, 2015 and \$196.4 million at December 27, 2014. The increase in working capital in the nine months ended September 26, 2015 was primarily due to an increase in cash due to improved operating results and decreased current liabilities.

Cash and cash equivalents consist of deposits held at banks, money market funds and U.S. government agency securities that at the time of purchase had maturities of 90 days or less. Marketable securities consist of U.S. government and agency securities. We typically invest in highly-rated securities with low probabilities of default. Our investment policy requires investments to be rated single-A or better, and limits the types of acceptable investments, issuer concentration and duration of the investment.

Our cash, cash equivalents and marketable securities totaled approximately \$183.8 million at September 26, 2015, as compared to \$163.8 million at December 27, 2014. The increase in our cash, cash equivalents and marketable securities balances was primarily due to improved operating results and lower use of cash to support working capital. We believe that we will be able to satisfy our working capital requirements for at least the next twelve months with the liquidity provided by our existing cash, cash equivalents and marketable securities. If we are unsuccessful in maintaining or growing our revenues, or maintaining or reducing our cost structure in an industry down-turn, or increasing our available cash through financing, our cash, cash equivalents and marketable securities may decline in fiscal 2015.

We utilize a variety of tax planning and financing strategies in an effort to manage our worldwide cash and deploy funds to locations where they are needed. As part of these strategies, we indefinitely reinvest a significant portion of our foreign earnings and our current plans do not demonstrate a need to repatriate these earnings. Should we require additional capital in the United States, we may elect to repatriate indefinitely reinvested foreign funds or raise capital in the United States. If we were to repatriate indefinitely reinvested foreign funds, we would be required to accrue and pay additional United States taxes less applicable foreign tax credits.



Days Sales Outstanding: Days sales outstanding from receivables, or DSO, were 46 days at September 26, 2015 compared with 59 days at December 27, 2014. Our DSO calculation is determined using the count back method and is based on gross accounts receivable (including accounts receivable for amounts in deferred revenue). The decrease in DSO is primarily due to changes in customer mix as compared to the year ended December 27, 2014.

|   | Nine Months Ended |               |
|---|-------------------|---------------|
|   | September 26,     | September 27, |
|   | 2015              | 2014          |
|   | (In thousands)    |               |
| Net cash provided by operating activities           | \$29,201          | \$ 5,415      |
| Net cash provided by investing activities           | 2,847             | 22,996        |
| Net cash (used in) provided by financing activities | \$(3,578)         | ) \$ 2,542    |

Cash flows from operating activities: Net cash provided by operating activities for the nine months ended September 26, 2015 was primarily attributable to improved operating results from increased revenues and decreased costs, and lower working capital necessary to support the increased revenues. We had a net loss of \$0.9 million and non-cash expenses of \$30.6 million, including \$17.9 million of depreciation and amortization, \$8.5 million of stock-based compensation, \$4.9 million of provision for excess and obsolete inventories and \$0.5 million of restructuring activities, which was partially offset by a \$1.0 million gain on the sale of long-lived assets and by \$0.2 million of foreign currency transaction gains.

The net change in operating assets and liabilities for the nine months ended September 26, 2015 resulted in a net use of cash of \$0.5 million, which was primarily comprised of \$6.3 million of cash used for inventory build, \$2.9 million of cash used in accrued liabilities due to payment of incentive compensation and a decrease of \$2.1 million in deferred revenues due to recognition of previously deferred revenues for which the revenue recognition criteria have been met. The above use of cash was offset by cash generation of \$8.3 million in accounts receivable from strong collections, \$1.2 million in accounts payable driven by payments on vendor obligations, \$0.8 million in income tax refunds and a decrease of \$0.1 million in prepaid expenses and other current assets.

The net change in operating assets and liabilities for the nine months ended September 27, 2014 resulted in a net use of cash of \$19.5 million and which was comprised of cash used of \$17.9 million in accounts receivable due to higher sales, \$10.7 million of cash used for inventory due to inventory build, \$1.6 million decrease in deferred revenues due to recognition of previously deferred revenues for which the revenue recognition criteria have been met and an increase of prepaid expenses and other current assets of \$1.1 million primarily from assets held for sale. The above use of cash was offset in part by an increase of \$6.0 million in accounts payable driven by the timing of our payments on vendor obligations, an increase of \$5.5 million in accrued liabilities due to incentive compensation, accrued payroll and warranty, \$0.2 million increase in deferred rent and other liabilities due to additional operating lease obligations and an increase in income tax payable of \$0.2 million.

Cash flows from investing activities: Net cash provided by investing activities for the nine months ended September 26, 2015 was primarily related to \$49.5 million of proceeds from maturities of marketable securities and \$1.2 million of proceeds from the sale of long-lived assets offset by purchases of marketable securities totaling \$41.3 million and cash used in the acquisition of property and equipment of \$6.6 million. We carefully monitor our investments to minimize risks and have not experienced other than temporary investment losses.

Net cash provided by investing activities for the nine months ended September 27, 2014 was primarily related to \$58.3 million of proceeds from maturities of marketable securities and \$0.8 million of proceeds from sales of property, plant and equipment offset by purchases of marketable securities totaling \$31.7 million and cash used in the acquisition of property and equipment of \$4.5 million.

Cash flows from financing activities: Net cash used in financing activities for the nine months ended September 26, 2015 included \$7.0 million used for the repurchase and retirement of our common stock partially offset by \$3.4 million from proceeds received from purchases under our 2012 Employee Stock Purchase Plan and stock option exercises. Net cash provided by financing activities for the nine months ended September 27, 2014 included \$2.8

million from proceeds received from purchases under our 2012 Employee Stock Purchase Plan.

Our cash, cash equivalents and marketable securities increased by \$20.0 million in the nine months ended September 26, 2015. We continue to focus on improving our operating efficiency to increase operating cash flows. We believe that we will be able to satisfy our cash requirements for at least the next twelve months with the liquidity provided by our existing cash, cash equivalents and marketable securities. To the extent necessary, we may also consider entering into short and long-term debt obligations, raise cash through a stock issuance, or to obtain new financing facilities which may not be available on terms favorable to us. Our future capital requirements may vary materially from those now planned. However, if we are unsuccessful in maintaining or growing our revenues, or maintaining or reducing our cost structure in an industry down-turn, or increasing

our available cash through financing, our cash, cash equivalents and marketable securities could decline in future fiscal quarters.

#### Contractual Obligations and Commitments

Our lease and purchase obligations have not materially changed as of September 26, 2015 from those disclosed in our Annual Report on Form 10-K for the year ended December 27, 2014.

#### Off-Balance Sheet Arrangements

Historically, we have not participated in transactions that have generated relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As of September 26, 2015, we were not involved in any such off-balance sheet arrangements.

#### Critical Accounting Policies and Estimates

Our critical accounting policies are disclosed in our Annual Report on Form 10-K for the year ended December 27, 2014. Our critical accounting policies have not changed during the nine months ended September 26, 2015.

#### Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, "Revenue from Contracts with Customers", and in August 2015 the FASB issued ASU 2015-14, "Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date," which defers the effective date of ASU 2014-09 by one year. ASU 2014-09 requires an entity to recognize revenue to depict the transfer of goods or services to customers in an amount that reflects the consideration to which an entity expects to be entitled in exchange for those goods or services. The guidance also requires expanded disclosures relating to the nature, amount, timing, and uncertainty of revenue and cash flows arising from contracts with customers. Additionally, qualitative and quantitative disclosures are required about customer contracts, significant judgments and changes in judgments, and assets recognized from the costs to obtain or fulfill a contract. The standard permits the use of either the retrospective or cumulative effect transition methods. This guidance will replace most existing revenue recognition guidance in United States generally accepted accounting principles when it becomes effective, which for us will be at the beginning of the first quarter of fiscal year 2018 using one of the two prescribed transition methods. Early adoption of one year prior to the required effective date is permitted. We are in the process of evaluating the impact of this guidance on our ongoing results and operations as well as in the transition methods prescribed above.

In July 2015, the FASB issued ASU 2015-11, which requires entities to measure most inventory "at the lower of cost and net realizable value," thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market (market in this context is defined as one of three different measures). The ASU will not apply to inventories that are measured by using either the last-in, first-out ("LIFO") method or the retail inventory method ("RIM"). The ASU is effective prospectively for annual periods beginning after December 15, 2016, and interim periods therein. Early application of the ASU is permitted. Upon transition, entities must disclose the nature of and reason for the accounting change. We do not believe adoption of this standard will have a material impact on our consolidated financial statements.

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

For financial market risks related to changes in interest rates and foreign currency exchange rates, reference is made to Item 7A: "Quantitative and Qualitative Disclosures about Market Risk" contained in Part II of our Annual Report on Form 10-K for the fiscal year ended December 27, 2014. Our exposure to market risk has not changed materially since December 27, 2014.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

Based on our management's evaluation (with the participation of our principal executive officer and principal financial officer), as of the end of the period covered by this report, our principal executive officer and principal financial officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the "Exchange Act")) are effective to ensure that information required to be disclosed by

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us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

#### Changes in Internal Control over Financial Reporting

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

#### Limitations on the Effectiveness of Controls

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

#### CEO and CFO Certifications

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

## PART II. OTHER INFORMATION

### Item 1. Legal Proceedings

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

### Item 1A. Risk Factors

There have been no material changes during the nine months ended September 26, 2015 to the risk factors discussed in our Annual Report on Form 10-K for the year ended December 27, 2014. If any of the identified risks actually occur, our business, financial condition and results of operations could suffer. The trading price of our common stock could decline and you may lose all or part of your investment in our common stock. The risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 27, 2014 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. We may make acquisitions and investments, which could put a strain on our resources, cause

ownership dilution to our stockholders and adversely affect our financial results.

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

Repurchase of Common Stock

On April 16, 2015, our Board of Directors authorized a program to repurchase up to \$25.0 million of outstanding common stock. Under the authorized stock repurchase program, we may repurchase shares from time to time on the open market. The pace of repurchase activity will depend on levels of cash generation, current stock price and other factors. The stock repurchase program was announced on April 16, 2015 and expires on April 15, 2016. The program may be modified or discontinued at any

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time. During the three months ended September 26, 2015, under this repurchase authorization, we repurchased and retired 472,800 shares of common stock for approximately \$3.5 million. During the nine months ended September 26, 2015, under this repurchase authorization, we repurchased and retired 873,162 shares of common stock for approximately \$7.0 million.

The following table summarizes our repurchases of outstanding common stock for the nine months ended September 26, 2015:

| Period (Fiscal months)             | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | Maximum Amount that May Yet Be Purchased Under the Plans or Programs |
|------------------------------------|----------------------------------|------------------------------|--|--|
| April 16, 2015-April 25, 2015      | —                                | \$—                          | —  | \$25,000,000   |
| April 26, 2015-May 23, 2015        | 215,500                          | 8.53                         | 215,500  | \$23,161,747   |
| May 24, 2015-June 27, 2015         | 184,862                          | 9.04                         | 184,862  | \$21,491,213   |
| June 28, 2015-July 25, 2015        | 300,000                          | \$7.88                       | 300,000  | \$19,128,287   |
| July 26, 2015-August 22, 2015      | 150,000                          | 6.58                         | 150,000  | \$18,140,248   |
| August 23, 2015-September 26, 2015 | 22,800                           | 6.00                         | 22,800   | \$18,003,461   |
|                                    | 873,162                          | \$8.01                       | 873,162  |  |

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





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Item 6. Exhibits

| Exhibit Number | Exhibit Description   | Incorporated by Reference |      |        | Filed Herewith |
|----------------|---|---------------------------|------|--------|----------------|
|                |   | Form                      | Date | Number |                |
| 31.01          | Certification of Chief Executive Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                             |                           |      |        | X              |
| 31.02          | Certification of Chief Financial Officer pursuant to 15 U.S.C. Section 7241, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                             |                           |      |        | X              |
| 32.01          | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |                           |      |        | *              |
| 101.INS        | XBRL Instance Document  |                           |      |        | X              |
| 101.SCH        | XBRL Taxonomy Extension Schema Document   |                           |      |        | X              |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase Document   |                           |      |        | X              |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase Document  |                           |      |        | X              |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase Document   |                           |      |        | X              |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase Document  |                           |      |        | X              |

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

SIGNATURE

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

FormFactor, Inc.

Date: October 28, 2015 By: /s/ Michael M. Ludwig

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

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