FSI INTERNATIONAL INC
Form 10-Q
January 05, 2006

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended November 26, 2005

or

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

For the transition period from ____________________ to ____________________

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

MINNESOTA	**41-1223238**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
3455 Lyman Boulevard, Chaska, Minnesota	**55318**
(Address of principal executive offices)	(Zip Code)

952-448-5440

(Registrant s telephone number, including area code)
N/A

(Former name, former address and former fiscal year, if changed since last report)

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.

þ **YES** o **NO**

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

þ **YES** o **NO**

Indicate the number of shares outstanding of each of the issuer s classes of common stock as of the latest practicable date:

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act.

o **YES** þ **NO**

Common Stock, no par value 29,920,000 shares outstanding as of December 30, 2005

FSI INTERNATIONAL, INC. AND SUBSIDIARIES
QUARTERLY REPORT ON FORM 10-Q

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PART I. ITEM 1. FINANCIAL STATEMENTS
FSI INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
NOVEMBER 26, 2005 AND AUGUST 27, 2005
(unaudited)
(in thousands)
ASSETS

	November 26, 2005	August 27, 2005
Current assets:		
Cash and cash equivalents	$ 4,009	$ 11,352
Restricted cash	140	282
Marketable securities	24,350	20,245
Trade accounts receivable, net of allowance for doubtful accounts of $886 and $922, respectively	21,573	21,393
Trade accounts receivable from affiliate	2,889	3,504
Inventories	24,641	24,717
Prepaid expenses and other current assets	7,244	6,924
Total current assets	84,846	88,417
Property, plant and equipment, at cost	77,936	77,726
Less accumulated depreciation and amortization	(56,707)	(56,170)
	21,229	21,556
Investment in affiliate	7,913	8,484
Other intangibles, net	1,649	1,784
Deposits and other assets	1,698	1,698
Total assets	$ 117,335	$ 121,939

(continued)

See accompanying notes to consolidated condensed financial statements.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS
NOVEMBER 26, 2005 AND AUGUST 27, 2005
(continued)
(unaudited)
(in thousands)
LIABILITIES AND STOCKHOLDERS EQUITY

	November 26, 2005	August 27, 2005
Current liabilities:		
Trade accounts payable	$ 5,616	$ 5,203
Accrued expenses	10,935	11,592
Customer deposits	670	1,220
Deferred profit	5,083	3,980
Deferred profit with affiliate	191	808
Total current liabilities	22,495	22,803
Stockholders equity:		
Preferred stock, no par value; 9,700 shares authorized; none issued and outstanding		
Series A Junior Participating Preferred Stock, no par value; 300 shares authorized; none issued and outstanding		
Common stock, no par value; 50,000 shares authorized; issued and outstanding, 29,892 and 29,874 shares, respectively	223,733	223,675
Accumulated deficit	(129,060)	(124,765)
Accumulated other comprehensive income	(61)	226
Other stockholders equity	228	
Total stockholders equity	94,840	99,136
Total liabilities and stockholders equity	$ 117,335	$ 121,939

See accompanying notes to consolidated condensed financial statements.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
FOR THE QUARTERS ENDED NOVEMBER 26, 2005 AND NOVEMBER 27, 2004
(unaudited)
(in thousands, except per share amounts)

	November 26, 2005	November 27, 2004
Sales (including sales to affiliate of $2,401 and $1,796, respectively)	$ 18,623	$ 19,445
Cost of goods sold	8,711	9,037
Gross profit	9,912	10,408
Selling, general and administrative expenses	8,464	8,466
Research and development expenses	5,875	5,422
Operating loss	(4,427)	(3,480)
Interest expense	(5)	(15)
Interest income	296	125
Other income, net	62	42
Loss before income taxes	(4,074)	(3,328)
Income taxes	13	6
Loss before equity in losses of affiliate	(4,087)	(3,334)
Equity in (losses) earnings of affiliate	(209)	58
Net loss	$ (4,296)	$ (3,276)
Net loss per common share Basic and diluted	$ (0.14)	$ (0.11)
Weighted average common shares	29,881	29,943
Weighted average common and potential common shares	29,881	29,943

See accompanying notes to consolidated condensed financial statements.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
FOR THE QUARTERS ENDED NOVEMBER 26, 2005 AND NOVEMBER 27, 2004
(unaudited)
(in thousands)

	November 26, 2005	November 27, 2004
OPERATING ACTIVITIES:		
Net loss	$ (4,296)	$ (3,276)
Adjustments to reconcile net loss to net cash used in operating activities:		
Stock compensation expense	284	
Depreciation	813	982
Amortization	134	380
Equity in losses (earnings) of affiliate	209	(58)
Changes in operating assets and liabilities:		
Accounts receivable	434	1,770
Inventories	75	(4,809)
Prepaid expenses and other current assets	(319)	(381)
Trade accounts payable	413	(2,355)
Accrued expenses	(712)	(535)
Customer deposits	(549)	(165)
Deferred profit	486	181
Net cash used in operating activities	(3,028)	(8,266)
INVESTING ACTIVITIES:		
Capital expenditures	(486)	(596)
Purchase of marketable securities	(118,550)	(102,925)
Sale of marketable securities	114,445	110,525
Dividend from affiliate	208	
Investment in license fee		(510)
Investment in affiliate		(490)
Net cash (used in) provided by investing activities	(4,383)	6,004
FINANCING ACTIVITIES:		
Decrease (increase) in restricted cash	142	(11)
Net proceeds from issuance of common stock	58	9
Net cash provided by (used in) financing activities	200	(2)
Effect of exchange rate on cash	(132)	495
Decrease in cash and cash equivalents	(7,343)	(1,769)

Cash and cash equivalents at beginning of period		11,352		10,344
Cash and cash equivalents at end of period	$	4,009	$	8,575

See accompanying notes to consolidated condensed financial statements.

FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

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

Description of Business

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

The Company announced the winding down of its Microlithography business in March 2003 and transitioned the Microlithography (uses light to transfer a circuit pattern unto a wafer) business to a POLARIS® Systems and Services (PSS) organization to focus on supporting the more than 300 installed POLARIS® Systems.

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

Consolidated Condensed Financial Statements

The accompanying consolidated condensed financial statements have been prepared by the Company without audit and reflect all adjustments (consisting only of normal and recurring adjustments, except as disclosed in the notes) which are, in the opinion of management, necessary to present a fair statement of the results for the interim periods presented. The statements have been prepared in accordance with the regulations of the Securities and Exchange Commission but omit certain information and footnote disclosures necessary to present the statements in accordance with accounting principles generally accepted in the United States of America. The results of operations for the interim periods presented are not necessarily indicative of the results to be expected for the full fiscal year. These consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and footnotes to the financial statements included in the Company s Annual Report on Form 10-K for the fiscal year ended August 27, 2005, as amended, previously filed with the Securities and Exchange Commission.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the purchase price is fixed or determinable and collectibility is reasonably assured. If the Company s equipment sales involve sales to its existing customers who have previously accepted the same type(s) of equipment with the same type(s) of specifications, the Company accounts for the product sale as a multiple element arrangement. The Company recognizes the equipment revenue upon shipment and transfer of title. The other elements may include installation, extended warranty contracts and training. Equipment installation revenue is valued based on estimated service person hours to complete installation and published or quoted service labor rates and is recognized when the installation has been completed. Training revenue is valued based on published training class prices and is recognized when the customers complete the training classes or when a customer-specific training period has expired. The published or quoted service labor rates and training class prices are rates actually charged and billed to the Company s customers.

All other product sales with customer specific acceptance provisions are recognized upon customer acceptance. Future revenues may be negatively impacted if the Company is unable to meet customer-specific acceptance criteria. Revenue related to spare parts sales is recognized upon shipment. Revenue related to maintenance and service contracts and extended warranty contracts is recognized ratably over the duration of the contracts.

The timing and amount of revenue recognized are dependent on the mix of revenue recognized upon shipment versus acceptance and for revenue recognized upon acceptance, they are dependent upon when customer specific criteria are met.

Other Comprehensive Income (Loss)

Other comprehensive income (loss) pertains to revenues, expenses, gains, and losses that are not included in net income (loss), but rather are recorded directly in stockholders equity. For the first quarters of fiscal 2006 and 2005, other comprehensive income (loss) consisted of foreign currency translation adjustments and unrealized holding gains on investments.

Cash and Cash Equivalents

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

Marketable Securities

The Company classifies its marketable equity securities as available-for-sale and carries these securities at amounts that approximate fair market value. As of February 26, 2005, the Company began to classify its investment in auction-rate securities as marketable securities. Previously, these investments were included in cash and cash equivalents. These investments totaled $24.4 million as of November 26, 2005 and $20.2 million as of August 27, 2005. This change in classification has no effect on the amounts of total current assets, total assets, net income, or cash flows from operations of the Company.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

Trade Accounts Receivable

Trade accounts receivable are recorded net of an allowance for doubtful accounts.

Allowance for Doubtful Accounts

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

Inventories and Inventory Reserves

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

Property, Plant and Equipment

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

Valuation of Long-Lived and Intangible Assets

The Company assesses the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

The Company amortizes intangible assets on a straight-line basis over their estimated economic lives which range from two to nine years. The estimated aggregate amortization of intangible assets for the next five years is $403,000 in the last nine months of fiscal 2006, $537,000 in fiscal 2007, $538,000 in fiscal 2008, $163,000 in fiscal 2009 and $8,000 in fiscal 2010.

If the Company determines that the carrying value of intangibles and long-lived assets may not be recoverable, the Company measures any impairment based on a projected discounted cash flow method using a discount rate determined by management to be commensurate with the risk inherent in its current business model or another valuation technique. Net intangible assets and long-lived assets amounted to $32.5 million as of November 26, 2005 and $33.5 million as of August 27, 2005.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
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(unaudited)

The Company has no intangible assets with indefinite useful lives. Intangible assets as of November 26, 2005 and August 27, 2005 consisted of the following (in thousands):

	As of November 26, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$ 9,150	$ 9,150	$
Patents	4,285	3,027	1,258
License fees	1,010	619	391
Other	420	420	
	$ 14,865	$ 13,216	$ 1,649

	As of August 27, 2005		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Developed technology	$ 9,150	$ 9,150	$
Patents	4,285	2,918	1,367
License fees	1,010	593	417
Other	420	420	
	$ 14,865	$ 13,081	$ 1,784

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

Investment in Affiliate

The Company s investment in affiliated companies consists of a 49% interest in m FSI LTD, a Japanese joint venture company formed in 1991. This investment is accounted for by the equity method utilizing a two-month lag due to the affiliate s year end.

The Company defers recognition of the profit on sales to m FSI LTD which remain in m FSI LTD s inventory based on the Company s ownership percentage of m FSI LTD.

The book value of the Company s long-term investment in affiliate is reviewed for other than temporary impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

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(unaudited)

Income Taxes

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

Product Warranty

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

Warranty provisions, claims and changes in estimates for the fiscal quarters ended November 26, 2005 and November 27, 2004 are as follows (in thousands):

	November 26, 2005	November 27, 2004
Beginning balance	$ 4,117	$ 4,575
Warranty provisions	328	203
Warranty claims	(423)	(103)
Changes in estimates	(356)	(384)
Ending balance	$ 3,666	$ 4,291

Foreign Currency Translation

Assets and liabilities denominated in foreign currencies are translated into U.S. dollars at current exchange rates. Operating results for investees and foreign subsidiaries are translated into U.S. dollars using the average or actual rates of exchange prevailing during the period. Foreign currency translation adjustments are included in the accumulated other comprehensive income account in stockholders equity.

Net Income (Loss) Per Common Share

Basic net income (loss) per common share is computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the period. Diluted net income per common share is computed using the treasury stock method to compute the weighted average number of common stock outstanding assuming the conversion of potential dilutive common shares. Diluted net loss per common share for fiscal quarters ended November 26, 2005 and November 27, 2004 does not include the effect of potential dilutive common shares as their inclusion would be antidilutive. The number of potential dilutive common shares excluded from the computation of diluted net loss per share was 3,944,000 for the first quarter of fiscal 2006 and 3,746,000 for the first quarter of fiscal 2005.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

Derivative Instruments and Hedging Activities

The Company does not use derivative financial instruments for trading or speculative purposes. The Company did not engage in any hedging activities during the first quarters of fiscal 2006 or 2005.

Use of Estimates

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

Employee Stock Plans

On August 28, 2005, we adopted the fair value recognition provisions of SFAS No. 123R, Share-Based Payment , using the modified prospective method. As a result, as of November 26, 2005, our results of operations reflected compensation expense for new stock options granted and vested under our stock incentive plan and employee stock purchase plan during the first quarter of fiscal 2006 and the unvested portion of previous stock option grants which vested during the first quarter of fiscal 2006. Amounts recognized in the financial statements related to stock-based compensation were as follows (in thousands, except for per share data):

	Quarters Ended November 26, 2005	Quarters Ended November 27, 2004
Total cost of stock-based compensation	$ 284	$
Amount capitalized in inventory and property and equipment		
Amounts charged against earnings, before income tax benefits	284	
Amount of income tax benefit recognized in earnings		
Amount charged against net earnings	$ 284	$
Impact on net loss per common share:		
Basic	$ 0.01	$
Diluted	$ 0.01	$

Stock-based compensation expense was reflected in the statement of operations for the first quarter of fiscal 2006 as follows (in thousands):

Cost of goods sold	$ 10
Selling, general and administrative	206
Research and development	68
	$ 284

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(unaudited)

Prior to the first quarter of fiscal 2006, we accounted for stock-based employee compensation arrangements in accordance with the provisions and related interpretations of Accounting Principles Board Opinion 25, Accounting for Stock Issued to Employees. Had compensation cost for stock-based compensation been determined consistent with SFAS No. 123R, the net loss and net loss per share would have been adjusted to the following pro forma amounts (in thousands, except for per share data):

	Quarter ended November 27, 2004	
Net loss, as reported	$	(3,276)
Employee stock-based compensation expense included in net earnings		
Less: stock-based employee compensation expense determined under fair value based method		(679)
Pro forma net loss	$	(3,955)
Net loss per share:		
Basic as reported	$	(0.11)
Basic pro forma	$	(0.13)
Diluted as reported	$	(0.11)
Diluted pro forma	$	(0.13)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing method. We use historical data to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free rate is based on the U.S. Treasury yield curve in effect at the time of grant for the estimated life of the option. The Company has not made any dividend payments nor does it have plans to pay dividends in the foreseeable future. The following assumptions were used to estimate the fair value of options granted during the first quarters of fiscal 2006 and 2005 using the Black-Scholes option-pricing model:

	Quarters ended	
	November 26, 2005	November 27, 2004
Volatility	69.3%	71.5%
Risk-free interest rates	4.2%	3.4%
Expected option life	5.6	5.2
Stock dividend yield		

FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

A summary of our option activity for the first quarter of fiscal 2006 is as follows (in thousands, except price per share and contractual term):

	Number of Shares	Weighted-average Exercise Price Per Share	Weighted-average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at August 27, 2005	4,001	$ 7.34		
Options granted	13	4.16		
Options forfeited	4	3.32		
Options expired	47	9.07		
Options exercised	19	3.17		
Outstanding at November 26, 2005	3,944	$ 7.33	6.4	
Exercisable at November 26, 2005	3,487	$ 7.84	6.1	

There was no aggregate intrinsic value for options outstanding or exercisable at November 26, 2005 as the average price of our stock for the first quarter of fiscal 2006 was less than the average exercise price of options outstanding or exercisable.

The weighted average grant date fair value based on the Black-Scholes option pricing model for options granted in the first quarter of fiscal 2006 was $2.46 per share and for options granted in the first quarter of fiscal 2005 was $2.49 per share. The total intrinsic value of options exercised during the first quarter of fiscal 2006 was $17,300 and during the first quarter of fiscal 2005 was $4,200.

A summary of the status of our unvested option shares as of November 26, 2005 is as follows (in thousands except fair value amounts):

	Number of Shares	Weighted-average Grant-Date Fair Value
Unvested at August 27, 2005	531	$ 3.43
Options granted	13	4.16
Options forfeited	4	3.32
Options vested	83	3.43
Unvested at November 26, 2005	457	$ 3.48

As of November 26, 2005, there was $683,000 of total unrecognized compensation cost related to unvested share-based compensation granted under our plans. That cost is expected to be recognized over a weighted-average period of 1.1 years. The total fair value of option shares vested during the first quarter of fiscal 2006 was $284,000 and the first quarter of fiscal 2005 was $679,000.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

New Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, Inventory Costs. This statement requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current period charges. In addition, this statement requires that the allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. This statement was effective for inventory costs incurred beginning in the Company s first quarter of fiscal 2006. The implementation of this statement did not have a material impact on the Company s results of operation or financial condition.

Reclassifications

Certain first quarter of fiscal 2005 amounts have been reclassified to conform to the current year presentation.

(2) Inventories

Inventories are summarized as follows (in thousands):

	November 26, 2005	August 27, 2005
Finished products	$ 2,328	$ 2,329
Work-in-process	11,553	9,971
Subassemblies	916	1,146
Raw materials and purchased parts	9,844	11,271
	$ 24,641	$ 24,717

(3) Accrued Expenses

Accrued expenses are summarized as follows (in thousands):

	November 26, 2005	August 27, 2005
Commissions	$ 119	$ 243
Salaries and benefits	2,301	2,707
Product warranty	3,666	4,117
Professional fees	710	719
Patent litigation	750	750
Income taxes	1,276	1,264
Other	2,113	1,792
	$ 10,935	$ 11,592

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

(4) Supplementary Cash Flow Information

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

	Quarters Ended	
	November 26, 2005	November 27, 2004
Interest paid, net	$ 5	$ 15

(5) Comprehensive Income (Loss)

Other comprehensive income (loss) pertains to revenues, expenses, gains and losses that are not included in the net loss but rather are recorded directly in stockholders equity. For the quarters ended November 26, 2005 and November 27, 2004, other comprehensive income (loss) consisted of the foreign currency translation adjustment and unrealized holding gains on investments and amounted to (in thousands):

	Quarters Ended	
	November 26, 2005	November 27, 2004
Net loss	($4,296)	($3,276)
Items of other comprehensive income (loss):		
Foreign currency translation	(287)	376
Unrealized holding gains on investments		(15)
Comprehensive loss	($4,583)	($2,915)

(6) Segment and Other Information

Segment information

The Company historically had two product lines, Surface Conditioning and POLARIS® Systems and Services and provided segment information. With the wind-down of the Microlithography business, which began in fiscal 2003, the Company has integrated the operations of its product lines.

In accordance with SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information, the Company s chief operating decision-maker has been identified as the President and Chief Executive Officer. Due to the level of integration of the two product lines, the Company s chief operating decision-maker reviews consolidated operating results to make decisions about allocating resources and assessing performance for the entire Company. The two product lines are a part of one segment for the manufacture, marketing and servicing of equipment for the microelectronics industry.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(unaudited)

(7) Litigation

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

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

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

Hsu Litigation

See Note 18 of the Notes to Consolidated Financial Statements in the Company s fiscal 2005 annual report on Form 10-K, as amended, for a discussion of the Hsu litigation.

YieldUP Patent Litigation

See Note 18 of the Notes to Consolidated Financial Statements in the Company s fiscal 2005 annual report on Form 10-K, as amended, for a discussion of the YieldUP patent litigation.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The information in this report, except for the historical information contains forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, and is subject to the safe harbor created by that statute. Typically, we identify forward-looking statements by use of an asterisk *. In some cases, you can identify forward-looking statements by terminology such as expects, anticipates, intends, may, should, plans, seeks, estimates, could, would, or the negative of such terms or other comparable terminology. These statements ar subject to various risks and uncertainties, both known and unknown. Factors that could cause actual results to differ include, but are not limited to, expected orders, revenues, net loss, cash usage and other financial performance for the second quarter of fiscal 2006; industry, semiconductor and equipment demand for calendar 2006; the length and extent of the current industry recovery; order delays or cancellations; general economic conditions; changes in customer capacity requirements and demand for microelectronics; the extent of demand for our products and our ability to meet demand; global trade policies; worldwide economic and political stability; our successful execution of internal performance plans; the cyclical nature of our business; volatility of the market for certain products; performance issues with key suppliers and subcontractors; the level of new orders; the timing and success of current and future product and process development programs; the success of our affiliated distributor in Japan; the success of our direct distribution organization; and the potential impairment of long-lived assets; as well as other factors listed from time to time in our SEC reports including, but not limited to, the Risk Factors included in this report. Readers also are cautioned not to place undue reliance on these forward-looking statements as actual results could differ materially. We undertake no duty to update any of the forward-looking statements after the date of this report.

This discussion and analysis should be read in conjunction with the Consolidated Condensed Financial Statements and footnotes thereto appearing elsewhere in this report.

Industry

Gartner Dataquest, an industry research group, is currently forecasting that:

- demand for semiconductors will increase approximately seven percent to $235 billion in calendar 2005 from $220 billion in the prior year, and that such increase will be driven by memory, micro component and ASSP (application-specific standard product) device demand;*

- semiconductor demand to grow approximately eight percent to $253 billion in calendar 2006;*

- demand for NOR (a type of flash memory chip with capabilities for applications in which programs run directly from memory) and NAND (a type of flash memory chip used for high density storage applications) and micro components to drive the increase in calendar 2006;*

- total equipment spending in calendar 2005 to decrease approximately 11 percent to $33 billion as compared to $38 billion in 2004;* and

- equipment spending to increase approximately eight percent to $36 billion in calendar 2006 based upon device manufacturers current factory utilization rates and the anticipated increase in semiconductor unit demand and return to double digit growth in calendar 2007 and 2008.*

Device manufacturers are managing capacity increases carefully and are asking equipment manufacturers to shorten equipment delivery lead times. We expect this trend to continue.*

We believe that global economic conditions will remain robust in calendar 2006 and the top semiconductor suppliers in the world will continue to add advanced 300mm capacity in an effort to reduce their unit manufacturing cost and meet leading edge device demand.* In addition, we believe that our broadening applications capability and focus on new product placements at the top spenders allows us the potential to grow faster than the market segments that we serve.*

Application of Critical Accounting Policies and Estimates

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

Our critical accounting policies and estimates are as follows:

- revenue recognition;
- valuation of long-lived and intangible assets; and
- estimation of valuation allowances and accrued liabilities, specifically product warranty, inventory reserves and allowance for doubtful accounts.

Revenue Recognition

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

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

Timing and amount of revenue recognized are dependent on the mix of revenue recognized upon shipment versus acceptance. For revenue recognized upon acceptance, they are dependent upon when customer-specific criteria are met.

Valuation of Long-Lived and Intangible Assets

We assess the impairment of identifiable intangibles and long-lived assets whenever events or changes in circumstances indicate that the carrying value may not be recoverable.

If we determine that the carrying value of intangibles and long-lived assets may not be recoverable, we measure any impairment based on a projected discounted cash flow method using a discount rate determined by our management to be commensurate with the risk inherent in our current business model or another valuation technique. Net intangible assets and long-lived assets amounted to $32.5 million as of November 26, 2005 and $33.5 million as of August 27, 2005.

Product Warranty Estimation

We record a liability for warranty claims at the time of sale. The amount of the liability is based on the trend in the historical ratio of claims to sales, releases of new products and other factors. The warranty periods for new equipment manufactured by us typically range from one to two years. Special warranty reserves are also accrued for major rework campaigns. Although management believes the likelihood to be relatively low, claims experience could be materially different from actual results because of the introduction of new, more complex products; competition or other external forces; manufacturing changes that could impact product quality; or as yet unrecognized defects in products sold.

Inventory Reserves Estimation

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

Allowance for Doubtful Accounts Estimation

Management must make estimates of the uncollectibility of our accounts receivable. The most significant risk is the risk of sudden unexpected deterioration in financial condition of a significant customer who is not considered in the allowance. Management specifically analyzes accounts receivable and analyzes historical bad debts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment terms when evaluating the adequacy of the allowance for doubtful accounts. Results could be materially impacted if the financial condition of a significant customer deteriorated and related accounts receivable are deemed uncollectible. Accounts receivable are charged off after management determines that they are uncollectible.

FIRST QUARTER OF FISCAL 2006 COMPARED WITH FIRST QUARTER OF FISCAL 2005

The Company

The following table sets forth for the fiscal quarter indicated, certain income and expense items as a percent of our total sales.

	Percent of Sales	
First quarter ended:	**November 26, 2005**	**November 27, 2004**
Sales	100.0%	100.0%
Cost of goods sold	46.8	46.5
Gross profit	53.2	53.5
Selling, general and administrative	45.5	43.5
Research and development	31.5	27.9
Operating loss	(23.8)	(17.9)
Other income, net	1.9	0.8
Losses before income taxes	(21.9)	(17.1)
Income taxes	0.1	
Equity in (losses) earnings of affiliate	(1.1)	0.3
Net loss	(23.1%)	(16.8%)

Sales Revenues and Shipments

Sales revenues decreased 4% to $18.6 million for the first quarter of fiscal 2006 as compared to $19.4 million for the first quarter of fiscal 2005. International sales were $12.7 million, representing 68% of total sales during the first quarter of fiscal 2006 and $13.3 million, representing 68% of total sales, during the first quarter of fiscal 2005. The decrease in the amount of total sales revenue related primarily to a decrease in sales to Europe, partially offset by an increase in sales to Asia.

Shipments in the first quarter of fiscal 2006 increased to $22.1 million from $19.6 million in the first quarter of fiscal 2005. The increase was primarily in domestic shipments.

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

We currently expect second quarter revenues to be between $20 and $24 million.* A portion of this expected revenue is subject to us receiving purchase orders or obtaining timely acceptance from our customers, including gaining acceptance for several systems that are now being qualified by customers.* Also, in the existing industry environment, customers could request delivery delays or cancel orders.

Gross Margin

Our gross profit margin fluctuates due to a number of factors, including the mix of products sold; the proportion of international sales, as international sales, particularly in Asia, generally have lower margins due to pricing pressures; the result of selling through our affiliate in Japan; utilization of manufacturing capacity; the sales of PSS product inventory previously written down to zero; and initial product placement discounts.

Gross profit as a percentage of sales was 53.2% for the first quarter of fiscal 2006 and was 53.5% for the first quarter of fiscal 2005.

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During the first quarter of fiscal 2006, we had sales of PSS product inventory with an original cost of $0.8 million that had previously been written down to zero. This was primarily due to sales revenues generated from unanticipated PSS refurbished systems, spare parts and upgrades sales. Our gross margin as a percentage of sales in the first quarter of fiscal 2006 would have been 49.0% if we had included in cost of goods sold the original cost of the PSS product inventory that had been written down to zero. Gross margin including the original cost of the PSS product inventory that had been written down to zero is not calculated in accordance with generally accepted accounting principles (GAAP). Our management believes that the presentation of gross margin including the original cost of the PSS inventory that had been written down to zero provides a useful analysis of our ongoing operating trends and helps investors compare our operating performance period over period. During the first quarter of fiscal 2005, we had no significant sales of PSS product inventory that had previously been written down to zero.

The following is a reconciliation of our first quarter fiscal 2006 gross margin calculated in accordance with GAAP to our first quarter fiscal 2006 gross margin including the original cost of PSS product inventory in cost of goods sold that had previously been written down to zero (in thousands):

	First Quarter Ended November 26, 2005 (GAAP)	% of Sales	Adjustment	First Quarter Ended November 26, 2005 (Non-GAAP)	% of Sales
Sales	$ 18,623			$ 18,623	
Cost of Goods Sold	8,711		$ 784 (1)	9,495	
Gross Margin	$ 9,912	53.2%		$ 9,128	49.0%

(1) Original cost of PSS product inventory sold that had previously been written down to zero.

We will continue to try to sell the impaired inventory to our customers as refurbished systems, spare parts and upgrades to existing systems. If unsuccessful, some of the items will be disposed of. Any significant sales of the impaired inventory will be disclosed. Gross margins will be higher if inventory carried at a reduced cost is sold.

Gross profit margins are expected to decrease to 44% to 46% of revenues for the second quarter of fiscal 2006, due to both a foreign/domestic sales mix and product mix shift compared to the first quarter of fiscal 2006.*

Selling, General and Administrative Expenses

Selling, general and administrative expenses were $8.5 million in the first quarters of fiscal 2006 and fiscal 2005.

Based upon our current operations, we expect selling, general and administrative expenses in the second quarter of fiscal 2006 to be in the range of $8.8 to $9.0 million as we continue to focus on supporting product evaluations in process at our customers facilities and increasing our field service headcount to support the anticipated increase in unit shipments in future quarters.*

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Research and Development Expenses

Research and development expenses were $5.9 million for the first quarter of fiscal 2006 and $5.4 million for the first quarter of fiscal 2005. The majority of our research and development investment is focused on expanding the applications capabilities of our products, supporting customer evaluations and expanding our product portfolio.

We expect research and development expenses to range from $5.9 to $6.1 million for the second quarter of fiscal 2006 as we continue to invest in new application and product development programs and continue to support our flagship products: the MAGELLAN, the ANTARES and the ZETA Systems.*

Other Income (Expense), Net

Other income (expense), net was approximately $353,000 of income for the first quarter of fiscal 2006 as compared to $152,000 of income for the first quarter of fiscal 2005. The increase relates primarily to an increase in interest income associated with higher interest rates.

Interest income for the second quarter of fiscal 2006 is expected to be between $200,000 to $300,000, given our current cash position and the anticipated interest rates.*

Income Tax

We recorded a tax expense of $13,000 in the first quarter of fiscal 2006 and $6,000 in the first quarter of fiscal 2005.

Our deferred tax assets on the balance sheet as of November 26, 2005 have been fully reserved for with a valuation allowance. We do not expect to significantly reduce our valuation allowance until we are consistently profitable on a quarterly basis.*

We have net operating loss carryforwards for federal income tax purposes of approximately $151.9 million, which will begin to expire in fiscal 2011 through fiscal 2023 if not utilized. Of this amount, approximately $15.0 million is subject to Internal Revenue Code Section 382 limitations on utilization. This limitation is approximately $1.4 million per year.

Tax legislation has been enacted to repeal certain export tax incentives that we have qualified for in the past. The legislation also includes provisions that allow for a deduction for qualified production activities. These provisions will not impact our tax rate in the near term due to the full valuation allowance. The longer term impact will depend on the level of our profitability and the domestic and foreign mix of earnings.

Equity in (Losses) Earnings of Affiliate

The equity in (losses) earnings of affiliate was approximately $209,000 of losses for the first quarter of fiscal 2006, compared to approximately $58,000 of income for the first quarter of fiscal 2005. The decrease related to m FSI LTD s operations.

We expect to report equity in earnings of affiliate between $200,000 to $300,000 in the second quarter of fiscal 2006 due to the expected timing of acceptance of m FSI LTD s products in their second quarter.*

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Net Loss

Assuming that we can achieve the expected revenues, gross margin, operating expenses, interest income and affiliate earning levels, we expect to report a net loss of approximately $3.5 to $4.5 million in the second quarter of fiscal 2006.*

Liquidity and Capital Resources

Our cash, restricted cash, cash equivalents and marketable securities were approximately $28.5 million as of November 26, 2005, a decrease of $3.4 million from the end of fiscal 2005. The decrease in cash, restricted cash, and cash equivalents was due primarily to $3.0 million of net cash used for operations, $0.5 million of property, plant and equipment acquisitions and $0.1 million of negative currency impact. The decreases were net of a $0.2 million dividend received from our affiliate, m FSI LTD.

Accounts receivables will fluctuate quarter to quarter depending on individual customers timing of ship dates, payment terms and cash flow conditions. Accounts receivable decreased $0.4 million from the end of fiscal 2005. The decrease in trade accounts receivable related to a decrease in shipments from $25.1 million in the fourth quarter of fiscal 2005 to $22.1 million in the first quarter of fiscal 2006.

Inventory was approximately $24.6 million at November 26, 2005 and $24.7 million at the end of fiscal 2005. The slight decrease in inventory related primarily to a decrease in raw materials offset by an increase in work-in-process inventory. Inventory reserves were $14.5 million at November 26, 2005, and $15.3 million at the end of fiscal 2005. The PSS product inventory reserves were $11.0 million at November 26, 2005 as compared to $11.7 million at the end of fiscal 2005. This decrease was primarily due to the sales in the first quarter of fiscal 2006 of PSS product inventory with an original cost of $0.8 million that had previously been written down to zero. Since we recorded the PSS product inventory reserves as a result of the wind-down of our Microlithography business in the second quarter of fiscal 2003, we have had sales of PSS product inventory that had previously been written down to zero and reductions in inventory buyback requirements of $7.5 million and have disposed of $6.6 million of PSS product inventory. The original cost of PSS product inventory available for sale or to be disposed of as of November 26, 2005 was $11.0 million.

Trade accounts payable increased approximately $0.4 million to $5.6 million as of November 26, 2005 as compared to $5.2 million at the end of fiscal 2005. The increase in trade accounts payable related primarily to the timing of inventory receipts.

Deferred profit increased approximately $0.5 million to $5.3 million as of November 26, 2005, as compared to $4.8 million at the end of fiscal 2005. The increase in deferred profit related primarily to the timing of system acceptances.

As of November 26, 2005, our current ratio was 3.8 to 1.0, and working capital was $62.4 million. We did not have any outstanding loans with our affiliate and had no lines of credit or guarantees of affiliate as of November 26, 2005. As of November 26, 2005, we had guarantees totaling $256,000 related to auto leases, VAT and payroll requirements in Europe. These guarantees were collateralized with $140,000 of restricted cash.

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

		Payments due by period			
Contractual Obligations:	Total	Less than 1 Year	1-3 years	3-5 years	More than 5 years
Operating Lease Obligations	$ 2,290	$ 1,056	$ 768	$ 466	$
Purchase Obligations	4,729	4,729			
Other Long-Term Liabilities [1]	3,388	1,138	500	500	1,250
Total	$ 10,407	$ 6,923	$ 1,268	$ 966	$ 1,250

[1] Other long-term liabilities represent payments related to a patent litigation settlement and minimum royalty payments or discounts granted under a license agreement.

Capital expenditures were $0.5 million in the first quarter of fiscal 2006 and $0.6 million in the first quarter of fiscal 2005. We expect capital expenditures to be less than $1.0 million in the second quarter of fiscal 2006.* Depreciation and amortization for the second quarter of fiscal 2006 is expected to be between approximately $1.0 and $1.2 million.*

At the second quarter expected run rate, we anticipate using between $2.5 and $3.5 million of net cash for operations, including the final patent litigation payment of $0.8 million, in the second quarter of fiscal 2006.* We believe that with existing cash, cash receipts, cash equivalents, marketable securities and internally generated funds, there will be sufficient funds to meet our currently projected working capital requirements, and to meet other cash requirements through at least fiscal 2006.* We believe that success in our industry requires substantial capital to maintain the flexibility to take advantage of opportunities as they arise. One of our strategic objectives is, as market and business conditions warrant, to consider divestitures, investments or acquisitions of businesses, products or technologies particularly those that are complementary to our surface conditioning business. We may fund such activities with additional equity or debt financing. The sale of additional equity or debt securities, whether to maintain flexibility or to meet strategic objectives, could result in additional dilution to our shareholders.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements.

New Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 151, Inventory Costs. This statement requires that items such as idle facility expense, excessive spoilage, double freight and rehandling costs be recognized as current period charges. In addition, this statement requires that the allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. This statement was effective for inventory costs incurred beginning in our first quarter of fiscal 2006. The implementation of this statement did not have a material impact on our results of operations or financial position.

In December 2004, the FASB issued SFAS No. 123 (Revised 2004), Share-Based Payment. SFAS No. 123R is a revision of SFAS No. 123, Accounting for Stock-Based Compensation and supersedes Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and its related implementation guidance. SFAS No. 123R focuses primarily on accounting for transactions in which an entity obtains employee services through share-based payment transactions. SFAS No. 123R

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requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the fair value of the award at the date of grant. The cost will be recognized over the period during which an employee is required to provide service in exchange for the award. SFAS No. 123R is effective as of the beginning of the first annual reporting period that begins after June 15, 2005 and we adopted this standard on August 28, 2005 using the modified prospective method. Our results of operations in the first quarter of fiscal 2006 reflected $284,000 of compensation expense for new stock options granted under our stock incentive plan, and for the unvested portion of previous stock options granted under our stock incentive plan and our employee stock purchase plan.

Risk Factors

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

- we may incur substantial costs to ensure the functionality and reliability of products early in their life cycle;

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- repeated defects or bugs can reduce orders, increase manufacturing costs, adversely impact working capital and increase service and warranty expenses; and
- we may require significant lead times between product introduction and commercialization.

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

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

In the past several years, we have seen a trend toward consolidation in the microelectronics equipment industry. We expect the trend toward consolidation to continue as companies seek to strengthen or maintain their market positions in a rapidly changing industry. We believe that industry consolidations may result in competitors that are better able to compete. This could have a significant negative impact on our business, operating results, and financial condition.

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

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

- difficulties in absorbing the new business, product line, or technology;
- diversion of management s attention from other business concerns;
- entering new markets in which we have little or no experience; and
- possible loss of key employees of the acquired business.

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

Our stock price has been volatile in the past and may continue to be so in the future. In the first quarter of fiscal 2006, our stock price ranged from $3.72 to $4.42 per share and in fiscal 2005, our stock price ranged from $3.22 to $5.56 per share.

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

- failure to meet the published expectations of securities analysts for a given period;
- changes in financial estimates by securities analysts;

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

additions or departures of key personnel; and

involvement in or adverse results from litigation.

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

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

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

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

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

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

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

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

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

As a result of these factors, our future operating results are difficult to predict. Further, we base our current and future expense plans in significant part on our expectations of our longer-term future revenue. As a result, we expect our expense levels to be relatively fixed in the short-run. An

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unanticipated decline in revenue for a particular quarter may disproportionately affect our net income in that quarter. If our revenue is below our projections, then our operating results will also be below expectations. Any one of the factors we list above, or a combination of them, could adversely affect our quarterly results of operations, and consequently may cause a decline in our share price.

Because of our ownership position in m FSI LTD., adverse results of m FSI LTD could adversely affect our results.

The profits or losses of our affiliate, m FSI LTD., can also significantly affect our financial results. We have a 49% interest in m FSI LTD. If this affiliate loses the business of a significant company for which it distributes or sells products, loses a significant customer, or otherwise became less financially viable, it could have a negative effect on our financial condition.

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

Almost all of our direct international sales are denominated in U.S. dollars. Nonetheless, changes in demand caused by fluctuations in interest and currency exchange rates may affect our international sales. Sales for m FSI LTD are denominated in yen. As a result, U.S. dollar/yen exchange rates may affect our equity interest in m FSI LTD s earnings.

m FSI LTD sometimes engages in so-called hedging or risk-reducing transactions to try to limit the negative effects that the devaluation of foreign currencies relative to the U.S. dollar could have on operating results. m FSI LTD will do so if a sale denominated in a foreign currency is sufficiently large to justify the costs of hedging. To hedge a sale, m FSI LTD typically will commit to buy U.S. dollars and sell the foreign currency at a given price at a future date. If the customer cancels the sale, m FSI LTD may be forced to buy U.S. dollars and sell the foreign currency at market rates to meet its hedging obligations and may incur a loss in doing so. To date, the hedging activities of m FSI LTD have not had any significant negative effect on us.

Because we assumed direct sales, service and applications support and logistics responsibilities for our products in Europe and the Asia Pacific region starting in March 2003, we incur labor, service and other expenses in foreign currencies. As of November 26, 2005, we had not entered into any hedging activities and our foreign currency transaction gains and losses for the first quarter of fiscal 2006 were insignificant. We intend to evaluate various hedging activities and other options to minimize fluctuations in interest and currency exchange rates. There is no assurance that we will be successful in minimizing foreign exchange rate risks and such failure may reduce our international sales or negatively impact our operating results.

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

We operate in a global market. In fiscal 2005, approximately 64% of our sales revenue derived from sales outside of the United States. In fiscal 2004, approximately 47% of our sales revenue derived from sales outside the United States. In fiscal 2003, approximately 38% of our sales revenue derived from sales outside the United States. We expect that international sales will continue to represent a significant portion of total sales. Sales to customers outside the United States involve a number of risks, including the following:

imposition of government controls;

compliance with U.S. export laws and foreign laws;

political and economic instability;

trade restrictions;

changes in taxes and tariffs;

longer payment cycles;

difficulty of administering business overseas; and

general economic conditions.

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

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

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

The microelectronics equipment industry is highly competitive. We face substantial competition throughout the world. We believe that to remain competitive, we will need significant financial resources to offer a broad range of products, to maintain customer service and support, and to invest in research and development. We believe that the microelectronics industry is becoming increasingly dominated by large manufacturers who have the resources to support customers on a worldwide basis. Some of our competitors have substantially greater financial, marketing, and customer-support capabilities than us. Large equipment manufacturers have or may enter the market areas in which we compete. In addition, smaller, emerging microelectronics equipment companies provide innovative technology. We expect that our competitors will continue to improve the design and performance of their existing products and processes. We also expect them to introduce new products and processes with better performance and pricing. We cannot guarantee that we will continue to compete effectively in the United States or elsewhere. We may be unable to continue to invest in marketing, research and development and engineering at the levels we believe necessary to maintain our competitive position. Our failure to make these investments could have a significant negative impact on our business, operating results and financial condition.

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

If our significant customers reduce, delay, or cancel orders, then our operating results could suffer. Our largest customers have changed from year to year, however, sales to our top five customers accounted for approximately 48% of total sales in fiscal 2005, 46% of total revenues in fiscal 2004 and 59% of total revenues in fiscal 2003. Texas Instruments accounted for approximately 14% of total sales in fiscal 2005, 16% of total sales in fiscal 2004 and 24% of total sales in fiscal 2003. Samsung

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Electronics accounted for approximately 11% of total sales in fiscal 2005. IBM accounted for approximately 14% of total sales in fiscal 2003. We currently have no long-term sales commitments with any of our customers. Instead, we generally make sales under purchase orders. All orders are subject to cancellation or delay by the customer.

Our backlog may not result in future net sales.

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

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

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

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

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

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

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

- our pending patent applications may not be issued or may be issued with more narrow claims;
- patents issued to us may be challenged, invalidated, or circumvented;
- rights granted under issued patents may not provide competitive advantages to us;
- foreign laws may not protect our intellectual property rights; and

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

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

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

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

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

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

We are subject to internal controls evaluations and attestation requirements of Section 404 of the Sarbanes-Oxley Act of 2002.

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, we must perform evaluations of our internal controls over financial reporting. Beginning as of the end of fiscal 2005 and annually thereafter, we must include with our Form 10-K a report on our management s assessment of the adequacy of such internal controls, and our independent registered public accounting firm must publicly attest to the adequacy of management s assessment and the effectiveness of our internal controls. We have implemented procedures for compliance. Compliance with these requirements is complex and time-consuming. If we fail to timely or successfully comply with the requirements of Section 404, or if our independent registered public accounting firm does not timely attest to the evaluation, we could be subject to increased regulatory scrutiny and the public s perception of us may change.

Changes to financial accounting standards may affect our reported results of operations.

We prepare our financial statements to conform with GAAP. The GAAP are subject to interpretation by the American Institute of Certified Public Accountants, the Securities and Exchange Commission, the Financial Accounting Standards Board and various bodies formed to interpret and create appropriate accounting policies. A change in those policies can have a significant effect on our reported results and may even affect our reporting of transactions completed before a change is announced.

Accounting policies affecting many other aspects of our business, including rules relating to purchase accounting for business combinations, revenue recognition, in-process research and development

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charges, employee stock purchase plans and stock option grants, have recently been revised or are under review. Changes to those rules or the questioning of our current accounting practices may have a material adverse effect on our reported financial results or on the way we conduct business. In addition, our preparation of financial statements in accordance with GAAP requires that we make estimates and assumptions that affect the recorded amounts of assets and liabilities, disclosure of those assets and liabilities at the date of the financial statement and the recorded amounts of expenses during the reporting period. A change in the facts and circumstances surrounding those estimates could result in a change to our estimates and could impact our future operating results.

We do not intend to pay dividends.

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

ITEM 3. QUANTATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our cash flows and earnings are subject to fluctuations in foreign exchange rates due to an investment in our foreign-based affiliate. As of November 26, 2005, our investment in affiliate included a 49% interest in m FSI LTD, which operates in Japan. We denominate the majority of our sales outside of the U.S. in U.S. dollars.

Because we assumed direct sales, service and applications support and logistics responsibilities for our products in Europe and the Asia Pacific region starting in March 2003, we have and will continue to incur labor, service and other expenses in foreign currencies. As a result, we may be exposed to fluctuations in foreign exchange rate risks.* As of November 26, 2005, we had not entered into any hedging activities and our foreign currency transaction gains and losses for the first quarter of fiscal 2006 were insignificant. We are currently evaluating various hedging activities and other options to minimize these risks.

We do not have significant exposure to changing interest rates as we currently have no long-term debt. As of November 26, 2005, amortized cost approximated market value for all outstanding marketable securities. We do not undertake any specific actions to cover our exposure to interest rate risk and we are not party to any interest rate risk management transactions. The impact on loss before income taxes of a 1% change in short-term interest rates would be approximately $285,000 based on cash, restricted cash, cash equivalents and marketable securities balances as of November 26, 2005.

ITEM 4. CONTROLS AND PROCEDURES

As of the end of the period covered by this report, we conducted an evaluation, under the supervision and with the participation of the principal executive officer and principal financial officer, of our disclosure controls and procedures (as defined in Rules 13a-14(c) and 15d-14(c) under the Securities Exchange Act of 1934 (the Exchange Act)). Based on this evaluation, the principal executive officer and the principal financial officer concluded that our disclosure controls and procedures are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms. There was no change in our internal control over financial reporting during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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FSI INTERNATIONAL, INC. AND SUBSIDIARIES
PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

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

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

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

Hsu Litigation

See Note 18 of the Notes to Consolidated Financial Statements in our fiscal 2005 annual report on Form 10-K, as amended, for a discussion of the Hsu litigation.

YieldUP Patent Litigation

See Note 18 of the Notes to Consolidated Financial Statements in our fiscal 2005 annual report on Form 10-K, as amended, for a discussion of the YieldUP patent litigation.

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

None

ITEM 3. Defaults upon Senior Securities

None

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

None

ITEM 5. Other Information

None

ITEM 6. Exhibits

(a) Exhibits

2.1	Agreement and Plan of Reorganization, dated as of January 21, 1999 among FSI International, Inc., BMI International, Inc. and YieldUP International Corporation (5)
2.2	Agreement and Plan of Reorganization by and Among FSI International, Inc., Spectre Acquisition Corp., and Semiconductor Systems, Inc. (1)
2.3	Asset Purchase Agreement dated as of June 9, 1999 between FSI International, Inc. and The BOC Group, Inc. (6)
3.1	Restated Articles of Incorporation of the Company. (2)
3.2	Restated and amended By-Laws. (9)
3.5	Articles of Amendment of Restated Articles of Incorporation (7)
3.6	Certificate of Designation, Preferences and Rights of Series A Junior Participating Preferred Shares.(3)
4.1	Form of Rights Agreement dated as of May 22, 1997 between FSI International, Inc. and Harris Trust and Savings Bank, National Association, as Rights Agent (3)
4.2	Amendment dated March 26, 1998 to Rights Agreement dated May 22, 1997 by and between FSI International, Inc. and Harris Trust and Saving Bank, National Association as Rights Agent. (4)
4.3	Amendment dated March 9, 2000 to Rights Agreement dated May 22, 1997, as amended March 26, 1998 by and between FSI International, Inc. and Harris Trust and Savings Bank as Rights Agent. (8)
4.4	Third Amendment dated April 3, 2002 to Rights Agreement dated May 22, 1997, as amended on March 26, 2008 and March 9, 2000 by and between FSI and Harris Trust and Savings Bank, as Rights Agent. (10)
31.1	Certification by Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(filed herewith)
31.2	Certification by Principal Finance and Accounting Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.(filed herewith)
32.1	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.(filed

herewith)

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

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

(3) Filed as an Exhibit to the Company s Report on Form 8-A, filed by the Company on June 5, 1997, SEC File No. 0-17276, and incorporated by reference.

(4) Filed as an Exhibit to the Company s Report on Form 8-A/A-1, filed by the Company on April 16, 1998, Sec File No. 0-17276

and incorporated by reference.

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

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

(8) Filed as an Exhibit to the Company s Report on Form 10-Q for the fiscal quarter ended May 27,

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

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(10) Filed as an Exhibit to the Company s Registration Statement on Form 8-A/A2, filed by the Company on April 9, 2002, SEC File No. 0-17276, and incorporated by reference.

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SIGNATURE

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

FSI INTERNATIONAL, INC.
....

[Registrant]

DATE: January 5, 2006

By: /s/ Patricia M. Hollister
Patricia M. Hollister,
Chief Financial Officer
on behalf of the
Registrant and as
Principal Financial and Accounting Officer

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INDEX TO EXHIBITS

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