

INTEVAC INC  
Form 10-Q  
May 03, 2011

**Table of Contents**

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549  
FORM 10-Q**

**(MARK ONE)**

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

**For the quarterly period ended April 2, 2011**

**OR**

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

**For the transition period from to**

**Commission file number 0-26946**

**INTEVAC, INC.**

**(Exact name of registrant as specified in its charter)**

**Delaware**

**(State or other jurisdiction of  
incorporation or organization)**

**94-3125814**

**(IRS Employer Identification No.)**

**3560 Bassett Street**

**Santa Clara, California 95054**

**(Address of principal executive office, including Zip Code)**

**Registrant's telephone number, including area code: (408) 986-9888**

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated  
filer

Accelerated  
filer

Non-accelerated filer   
(Do not check if a smaller reporting  
company)

Smaller reporting  
company

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

On May 3, 2011, 22,838,418 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

**INTEVAC, INC.  
INDEX**

<b>No.</b>		<b>Page</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>		
<b><u>Item 1.</u></b>	<b><u>Financial Statements (unaudited)</u></b>	
	<u>Condensed Consolidated Balance Sheets</u>	3
	<u>Condensed Consolidated Statements of Operations</u>	4
	<u>Condensed Consolidated Statements of Cash Flows</u>	5
	<u>Notes to Condensed Consolidated Financial Statements</u>	6
<b><u>Item 2.</u></b>	<b><u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	20
<b><u>Item 3.</u></b>	<b><u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	27
<b><u>Item 4.</u></b>	<b><u>Controls and Procedures</u></b>	28
<b><u>PART II. OTHER INFORMATION</u></b>		
<b><u>Item 1.</u></b>	<b><u>Legal Proceedings</u></b>	29
<b><u>Item 1A.</u></b>	<b><u>Risk Factors</u></b>	29
<b><u>Item 2.</u></b>	<b><u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	37
<b><u>Item 3.</u></b>	<b><u>Defaults Upon Senior Securities</u></b>	37
<b><u>Item 4.</u></b>	<b><u>(Removed and Reserved)</u></b>	37
<b><u>Item 5.</u></b>	<b><u>Other Information</u></b>	37
<b><u>Item 6.</u></b>	<b><u>Exhibits</u></b>	37
	<b><u>SIGNATURES</u></b>	37
	<u>EX-10.2</u>	
	<u>EX-10.3</u>	
	<u>EX-23.2</u>	
	<u>EX-31.1</u>	
	<u>EX-31.2</u>	
	<u>EX-32.1</u>	

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements**

**INTEVAC, INC.  
CONDENSED CONSOLIDATED BALANCE SHEETS**

	<b>April 2, 2011</b>	<b>December 31, 2010</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except par value)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 25,879	\$ 109,520
Short-term investments	50,263	4,994
Trade, note and other accounts receivable, net of allowances of \$55 at both April 2, 2011 and December 31, 2010	17,560	25,911
Inventories	21,764	20,671
Prepaid expenses and other current assets	6,890	6,630
Deferred income tax assets	3,304	3,124
 Total current assets	 125,660	 170,850
Property, plant and equipment, net	15,252	13,918
Long-term investments	52,294	22,866
Goodwill	18,389	18,389
Other intangible assets, net of amortization of \$1,937 at April 2, 2011 and \$1,801 at December 31, 2010	6,848	6,984
Deferred income taxes and other long-term assets	20,333	18,764
 Total assets	 \$ 238,776	 \$ 251,771
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 5,147	\$ 5,562
Accrued payroll and related liabilities	4,578	11,365
Other accrued liabilities	10,612	11,104
Customer advances	4,805	4,867
 Total current liabilities	 25,142	 32,898
Other long-term liabilities	10,973	11,630
Stockholders' equity:		
Common stock, \$0.001 par value	23	23
Additional paid-in capital	142,281	139,824
Accumulated other comprehensive income	247	255
Retained earnings	60,110	67,141
 Total stockholders' equity	 202,661	 207,243

Total liabilities and stockholders' equity	\$ 238,776	\$ 251,771
--------------------------------------------	------------	------------

Note: Amounts as of December 31, 2010 are derived from the December 31, 2010 audited consolidated financial statements.

See accompanying notes.

3

---

**Table of Contents**

**INTEVAC, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

	<b>Three months ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>
	<b>(Unaudited)</b>	
	<b>(In thousands, except per share amounts)</b>	
Net revenues:		
Systems and components	\$ 15,491	\$ 28,911
Technology development	1,932	4,231
Total net revenues	17,423	33,142
Cost of net revenues:		
Systems and components	9,614	15,902
Technology development	1,429	2,762
Total cost of net revenues	11,043	18,664
Gross profit	6,380	14,478
Operating expenses:		
Research and development	9,012	6,544
Selling, general and administrative	6,885	6,567
Total operating expenses	15,897	13,111
Income (loss) from operations	(9,517)	1,367
Interest income and other, net	129	391
Income (loss) before income taxes	(9,388)	1,758
Provision for (benefit from) income taxes	(2,357)	328
Net income (loss)	\$ (7,031)	\$ 1,430
Net income (loss) per share:		
Basic	\$ (0.31)	\$ 0.06
Diluted	\$ (0.31)	\$ 0.06
Weighted average common shares outstanding:		
Basic	22,727	22,196
Diluted	22,727	22,975

See accompanying notes.

**Table of Contents**

**INTEVAC, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Three months ended</b>	
	<b>April 2,</b>	<b>April 3,</b>
	<b>2011</b>	<b>2010</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>Operating activities</b>		
Net income (loss)	\$ (7,031)	\$ 1,430
Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	1,388	1,489
Net amortization of investment premiums and discounts	222	
Equity-based compensation	962	617
Change in the fair value of acquisition-related contingent consideration	300	
Deferred income taxes	(2,385)	34
Loss on disposal of equipment	31	
Changes in operating assets and liabilities	(1,070)	19,772
 Total adjustments	 (552)	 21,912
 Net cash and cash equivalents provided by (used in) operating activities	 (7,583)	 23,342
<b>Investing activities</b>		
Purchases of investments	(76,940)	(2,999)
Proceeds from sales and maturities of investments	1,995	6,250
Purchases of leasehold improvements and equipment	(2,617)	(791)
 Net cash and cash equivalents provided by (used in) investing activities	 (77,562)	 2,460
<b>Financing activities</b>		
Proceeds from issuance of common stock	1,495	916
 Net cash and cash equivalents provided by financing activities	 1,495	 916
Effect of exchange rate changes on cash and cash equivalents	9	20
 Net increase (decrease) in cash and cash equivalents	 (83,641)	 26,738
Cash and cash equivalents at beginning of period	109,520	17,592
 Cash and cash equivalents at end of period	 \$ 25,879	 \$ 44,330

See accompanying notes.

**Table of Contents**

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

**1. Basis of Presentation*****Basis of Presentation***

In the opinion of management, the unaudited interim condensed consolidated financial statements of Intevac, Inc. and its subsidiaries (Intevac or the Company) included herein have been prepared on a basis consistent with the December 31, 2010 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Intevac's Annual Report on Form 10-K for the fiscal year ended December 31, 2010 (2010 Form 10-K). Intevac's results of operations for the three months ended April 2, 2011 are not necessarily indicative of future operating results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

**2. New Accounting Pronouncement**

In January 2009, the Securities and Exchange Commission (SEC) issued Release No. 33-9002, Interactive Data to Improve Financial Reporting. The final rule requires companies to provide their financial statements and financial statement schedules to the SEC and on their corporate websites in interactive data format using the extensible Business Reporting Language (XBRL). The rule was adopted by the SEC to improve the ability of financial statement users to access and analyze financial data. The SEC adopted a phase-in schedule indicating when registrants must furnish interactive data. Under this schedule, Intevac will be required to submit filings with financial statement information using XBRL commencing with its July 2, 2011 quarterly report on Form 10-Q. Intevac is currently evaluating the impact of XBRL reporting on its financial reporting process.

**3. Inventories**

Inventories are stated at the lower of average cost or market and consist of the following:

	<b>April 2, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Raw materials	\$ 10,500	\$ 13,370
Work-in-progress	9,668	5,295
Finished goods	1,596	2,006
	<b>\$ 21,764</b>	<b>\$ 20,671</b>

Finished goods inventory consists primarily of completed systems at customer sites that are undergoing installation and acceptance testing.



**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**4. Equity-Based Compensation**

At April 2, 2011, Intevac had equity-based awards outstanding under the 2004 Equity Incentive Plan (the 2004 Plan ) and the 2003 Employee Stock Purchase Plan (the ESPP ). Intevac s stockholders approved both of these plans.

The 2004 Plan permits the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. During the three months ended April 2, 2011, Intevac granted 26,000 stock options with an estimated total grant-date fair value of \$185,000. Of this amount, estimated awards of \$46,000 are not expected to vest. During the three months ended April 3, 2010, Intevac granted 87,500 stock options with an estimated total grant-date fair value of \$765,000. Of this amount, estimated awards of \$195,000 are not expected to vest.

The ESPP provides that eligible employees may purchase Intevac s common stock through payroll deductions at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase interval. Offering periods are generally two years in length, and consist of a series of six-month purchase intervals. Eligible employees may join the ESPP at the beginning of any six-month purchase interval. During the three months ended April 2, 2011, Intevac granted purchase rights with an estimated total grant-date fair value of \$1.3 million. During the three months ended April 3, 2010, Intevac granted purchase rights with an estimated total grant-date fair value of \$48,000.

**Compensation Expense**

The effect of recording equity-based compensation for the three-month periods ended April 2, 2011 and April 3, 2010 was as follows:

	<b>Three Months Ended</b>	
	<b>April</b>	
	<b>2,</b>	<b>April 3,</b>
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Equity-based compensation by type of award:		
Stock options	\$ 731	\$ 487
Employee stock purchase plan	231	130
Total equity-based compensation	962	617
Tax effect on equity-based compensation	(269)	(193)
Net effect on net income (loss)	\$ 693	\$ 424

**Valuation Assumptions**

The fair value of share-based payment awards is estimated at the grant date using the Black-Scholes option valuation model. The determination of fair value of share-based payment awards on the date of grant using an option-pricing model is affected by our stock price as well as assumptions regarding a number of highly complex and subjective variables. These variables include, but are not limited to, our expected stock price volatility over the term of the awards, and actual employee stock option exercise behavior.

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

The weighted-average estimated value of employee stock options granted during the three months ended April 2, 2011 and April 3, 2010 was \$7.11 per share and \$8.75 per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the ESPP during the three months ended April 2, 2011 and April 3, 2010 was \$5.18 per share and \$4.78 per share, respectively. The fair value of each option and employee stock purchase right grant is estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	<b>Three Months Ended</b>	
	<b>April</b>	<b>April</b>
	<b>2,</b>	<b>3,</b>
	<b>2011</b>	<b>2010</b>
Stock Options:		
Expected volatility	64.89%	68.34%
Risk free interest rate	2.00%	2.42%
Expected term of options (in years)	4.6	4.5
Dividend yield	None	None
Stock Purchase Rights:		
Expected volatility	52.40%	55.48%
Risk free interest rate	0.51%	0.44%
Expected term of purchase rights (in years)	1.23	0.75
Dividend yield	None	None

The computation of the expected volatility assumptions used in the Black-Scholes calculations for new grants and purchase rights is based on the historical volatility of Intevac's stock price, measured over a period equal to the expected term of the grant or purchase right. The risk-free interest rate is based on the yield available on U.S. Treasury Strips with an equivalent remaining term. The expected term of employee stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the equity-based awards and vesting schedules. The expected term of purchase rights represents the period of time remaining in the current offering period. The dividend yield assumption is based on Intevac's history of not paying dividends and the assumption of not paying dividends in the future.

As the equity-based compensation expense recognized in the Condensed Consolidated Statements of Operations is based on awards ultimately expected to vest, such amount has been reduced for estimated forfeitures. Forfeitures were estimated based on Intevac's historical experience, which Intevac believes to be indicative of Intevac's future experience.

#### **5. Business Combination, Goodwill and Purchased Intangible Assets, Net**

On November 19, 2010, Intevac acquired the outstanding shares of Solar Implant Technologies, Inc. (SIT), a privately-owned, development stage company, creating an ion implant module to be used in the manufacturing of photovoltaic cells. Intevac's primary reasons for this acquisition were to complement its existing product offerings and to provide opportunities for future growth. The preliminary aggregate purchase price was \$12.4 million, which consisted of an initial cash payment totaling \$2.7 million and a contingent consideration obligation with a fair value of \$9.7 million payable in cash. In connection with the acquisition, Intevac acquired \$4.0 million of IPR&D, \$43,000 of tangible assets, and \$10.5 million of goodwill and assumed \$703,000 of tangible liabilities. Intevac also recorded an \$827,000 net deferred tax liability to reflect the tax impact of the identified intangible assets that will not generate tax deductible amortization expense net of the future tax benefit of acquired net operating loss carryforwards. The value attributable to IPR&D has been capitalized as an indefinite-lived intangible asset. Goodwill is attributable to estimated synergies arising from the acquisition and other intangible assets that do not qualify for separate recognition. Goodwill

is not deductible for tax purposes.

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

In connection with the acquisition of SIT, Intevac agreed to pay up to an aggregate of \$7.0 million in cash to the selling shareholders if certain milestones are achieved over a specified period. Intevac estimated the fair value of this contingent consideration to be in the amount of \$5.6 million based on the probability that certain milestones would be met and the payments would be made on the targeted dates outlined in the acquisition agreement.

In connection with the acquisition of SIT, Intevac also agreed to pay a revenue earnout on Intevac's net revenue from commercial sales of certain products over a specified period up to an aggregate of \$9.0 million in cash to the selling shareholders. Intevac estimated the fair value of this contingent consideration to be in the amount of \$4.1 million based on probability-based forecasted revenues reflecting Intevac's own assumptions concerning future revenue of SIT. A change in the estimated probabilities of revenue achievement could have a material effect on the statement of operations and balance sheets in the period of change.

Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the statement of operations. The fair value of the contingent consideration increased \$300,000 during the three months ended April 2, 2011.

Prior to the acquisition, Intevac had an equity interest in SIT with a cost basis of \$94,000 that was accounted for under the cost method. As a result of revaluing Intevac's equity interest in SIT on the acquisition date, the Company recognized a gain of \$481,000, which was included in other income, net, in the consolidated statement of operations during the fourth quarter of fiscal 2010.

Intevac accounted for the acquisition of SIT as a business combination. Under business combination accounting, the assets and liabilities of SIT were recorded as of the acquisition date, at their respective fair values, and consolidated with the Company. The preliminary purchase price allocation is based on estimates of the fair value of assets acquired and liabilities assumed. Subsequent to the acquisition in the fourth quarter of fiscal 2010, Intevac paid in full \$177,000 in notes payable to certain selling shareholders assumed upon the acquisition. The purchase price was allocated as follows:

**(In thousands)**

Current assets (including cash of \$38)	\$ 40
Property, plant, and equipment	3
IPR&D	4,000
Goodwill	10,484
Long-term deferred tax assets	697
<b>Total assets acquired</b>	<b>15,224</b>
Notes payable to sellers	177
Current liabilities	526
Long-term deferred tax liabilities	1,524
<b>Total liabilities assumed</b>	<b>2,227</b>
<b>Net assets acquired</b>	<b>\$ 12,997</b>

The results of operations for SIT for periods prior to the acquisition were not material to Intevac's consolidated statements of operations and, accordingly, pro forma financial information has not been presented.

Goodwill and indefinite-life intangible assets are tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill and indefinite-life intangible assets may be impaired. In the fourth quarter of fiscal 2010, Intevac performed its annual impairment analysis and the results of the



**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

analysis indicated that Intevac's goodwill and purchased intangible assets with an indefinite useful life were not impaired. At April 2, 2011, Intevac had a total of \$18.4 million of goodwill and \$4.1 million of indefinite-life intangible assets. At April 2, 2011, \$10.5 million of goodwill is attributed to the Equipment segment and \$7.9 million of goodwill is attributed to the Intevac Photonics segment.

Total amortization expense of finite-lived intangibles for the three months ended April 2, 2011 was \$136,000. As of April 2, 2011, future amortization expense is expected to be \$406,000 for the remainder of 2011, \$541,000 for 2012, \$541,000 for 2013, \$363,000 for 2014, \$284,000 for 2015 and \$593,000 thereafter. Intangible assets by segment are as follows: Equipment: \$5.9 million and Intevac Photonics: \$945,000.

**6. Warranty**

Intevac provides for the estimated cost of warranty when revenue is recognized. Intevac's warranty is per contract terms, and for systems sold directly the warranty typically ranges between 12 and 24 months from customer acceptance. For systems sold through a distributor, Intevac offers a 3 month warranty. The remainder of any warranty period is the responsibility of the distributor. During this warranty period any defective non-consumable parts are replaced and installed at no charge to the customer. The warranty period on consumable parts is limited to their reasonable usable lives. Intevac uses estimated repair or replacement costs along with its historical warranty experience to determine its warranty obligation. Intevac generally provides a twelve month warranty on its Intevac Photonics products. The provision for the estimated future costs of warranty is based upon historical cost and product performance experience. Intevac exercises judgment in determining the underlying estimates.

On the Condensed Consolidated Balance Sheets, the short-term portion of the warranty provision is included in other accrued liabilities, while the long-term portion is included in other long-term liabilities. The expense associated with product warranties issued or adjusted is included in cost of net revenues on the Condensed Consolidated Statements of Operations.

The following table displays the activity in the warranty provision account for the three-month periods ended April 2, 2011 and April 3, 2010:

	<b>Three months ended</b>	
	<b>April</b>	
	<b>2,</b>	<b>April 3,</b>
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Beginning balance	\$ 3,415	\$ 1,602
Expenditures incurred under warranties	(817)	(591)
Accruals for product warranties issued during the reporting period	380	764
Adjustments to previously existing warranty accruals	114	79
Ending balance	\$ 3,092	\$ 1,854

The following table displays the balance sheet classification of the warranty provision account at April 2, 2011 and at December 31, 2010:

	<b>April</b>	<b>December</b>
	<b>2,</b>	<b>31,</b>
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Other accrued liabilities	\$ 2,371	\$ 2,612
Other long-term liabilities	721	803

Total warranty provision	\$ 3,092	\$	3,415
--------------------------	----------	----	-------

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**7. Guarantees*****Officer and Director Indemnifications***

As permitted or required under Delaware law and to the maximum extent allowable under that law, Intevac has certain obligations to indemnify its current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at Intevac's request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the corporation and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments Intevac could be required to make under these indemnification obligations is unlimited; however, Intevac has a director and officer insurance policy that mitigates Intevac's exposure and enables Intevac to recover a portion of any future amounts paid. As a result of Intevac's insurance policy coverage, Intevac believes the estimated fair value of these indemnification obligations is not material.

***Other Indemnifications***

As is customary in Intevac's industry, many of Intevac's contracts provide remedies to certain third parties such as defense, settlement, or payment of judgments for intellectual property claims related to the use of its products. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.

**8. Cash, Cash Equivalents and Investments**

Cash and cash equivalents, short-term investments and long-term investments consist of:

	Amortized Cost	April 2, 2011 Unrealized Holding Gains      Unrealized Holding Losses		Fair Value
		(In thousands)		
Cash and cash equivalents:				
Cash	\$ 19,091	\$	\$	\$ 19,091
Commercial paper	3,000			3,000
Money market funds	3,788			3,788
<b>Total cash and cash equivalents</b>	<b>\$ 25,879</b>	<b>\$</b>	<b>\$</b>	<b>\$ 25,879</b>
Short-term investments:				
Commercial paper	\$ 19,237	\$ 4	\$	\$ 19,241
Corporate bonds and medium-term notes	9,892	10	2	9,900
Municipal bonds	2,232		1	2,231
U.S. treasury and agency securities	7,513	3		7,516
Variable rate demand notes ( VRDNs )	11,375			11,375
<b>Total short-term investments</b>	<b>\$ 50,249</b>	<b>\$ 17</b>	<b>\$ 3</b>	<b>\$ 50,263</b>
Long-term investments:				
Corporate bonds and medium-term notes	\$ 24,653	\$ 1	\$ 42	\$ 24,612
Municipal bonds	3,432	4		3,436
U.S. treasury and agency securities	13,977		12	13,965
Auction rate securities ( ARS )	10,900		619	10,281
<b>Total long-term investments</b>	<b>\$ 52,962</b>	<b>\$ 5</b>	<b>\$ 673</b>	<b>\$ 52,294</b>



Edgar Filing: INTEVAC INC - Form 10-Q

Total cash, cash equivalents, and investments	\$ 129,090	\$ 22	\$ 676	\$ 128,436
-----------------------------------------------	------------	-------	--------	------------

11

---

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

		<b>December 31, 2010</b>		
	<b>Amortized</b>	<b>Unrealized</b>	<b>Unrealized</b>	
	<b>Cost</b>	<b>Holding</b>	<b>Holding</b>	<b>Fair Value</b>
		<b>Gains</b>	<b>Losses</b>	
		<b>(In thousands)</b>		
Cash and cash equivalents:				
Cash	\$ 22,887	\$	\$	\$ 22,887
Commercial paper	2,999		1	2,998
Corporate bonds	1,259			1,259
Money market funds	82,376			82,376
<b>Total cash and cash equivalents</b>	<b>\$ 109,521</b>	<b>\$</b>	<b>\$ 1</b>	<b>\$ 109,520</b>
Short-term investments:				
Commercial paper	\$ 2,995	\$	\$	\$ 2,995
U.S. treasury and agency securities	1,999			1,999
<b>Total short-term investments</b>	<b>\$ 4,994</b>	<b>\$</b>	<b>\$</b>	<b>\$ 4,994</b>
Long-term investments:				
U.S. treasury and agency securities	\$ 6,978	\$ 5	\$	\$ 6,983
Corporate bonds and medium-term notes	5,615		5	5,610
ARS	10,900		627	10,273
<b>Total long-term investments</b>	<b>\$ 23,493</b>	<b>\$ 5</b>	<b>\$ 632</b>	<b>\$ 22,866</b>
<b>Total cash, cash equivalents, and investments</b>	<b>\$ 138,008</b>	<b>\$ 5</b>	<b>\$ 633</b>	<b>\$ 137,380</b>

The contractual maturities of available-for-sale securities at April 2, 2011 are presented in the following table.

	<b>Amortized</b>	
	<b>Cost</b>	<b>Fair Value</b>
	<b>(In thousands)</b>	
Due in one year or less	\$ 44,661	\$ 44,676
Due after one through five years (1)	41,042	40,988
Due after five through ten years (2)	1,500	1,500
Due after ten years(3)	22,796	22,181
	<b>\$ 109,999</b>	<b>\$ 109,345</b>

(1) Includes \$575,000 in par value of VRDNs.

(2) Includes \$1.5 million in par value of VRDNs.

(3) Includes \$9.3 million in par value of VRDNs and \$10.9 million in par value of ARS.



Table of Contents

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

The following table provides the fair market value of Intevac's investments with unrealized losses that are not deemed to be other-than-temporarily impaired as of April 2, 2011.

	April 2, 2011			
	In Loss Position for Less than 12 Months	Gross Unrealized Losses	In Loss Position for Greater than 12 Months	Gross Unrealized Losses
	Fair Value	(In thousands)	Fair Value	Losses
Corporate bonds and medium-term notes	\$ 23,938	\$ 44	\$	\$
Municipal bonds	1,231	1		
U.S. treasury and agency securities	14,482	12		
ARS			10,281	619
	\$ 39,651	\$ 57	\$ 10,281	\$ 619

All prices for the fixed maturity securities including U.S. Treasury and agency securities, commercial paper, corporate bonds, VRDNs and municipal bonds are received from independent pricing services utilized by Intevac's outside investment manager. This investment manager performs a review of the pricing methodologies and inputs utilized by the independent pricing services for each asset type priced by the vendor. In addition, on at least an annual basis, the investment manager conducts due diligence visits and interviews with each pricing vendor to verify the inputs utilized for each asset class. The due diligence visits include a review of the procedures performed by each vendor to ensure that pricing evaluations are representative of the price that would be received to sell a security in an orderly transaction. Any pricing where the input is based solely on a broker price is deemed to be a Level 3 price. Intevac uses the pricing data obtained from its outside investment manager as the primary input to make its assessments and determinations as to the ultimate valuation of above-mentioned securities and has not made, during the periods presented, any material adjustments to such inputs.

VRDNs are long-term floating rate municipal bonds with embedded put options that allow the bondholder to sell the security at par plus accrued interest. Intevac's VRDN portfolio is comprised of investments in many municipalities, which are secured by irrevocable letters of credit from major financial institutions or other highly rated companies that serve as the pledged liquidity source. Intevac can tender these VRDN securities for sale upon notice to the broker and receive payment for the tendered securities within seven days.

As of April 2, 2011, Intevac's investment portfolio included ARS with an aggregate par value of \$10.9 million. All of the ARS are student loan structured issues, where the loans have been originated under the U.S. Department of Education's Federal Family Education Loan Program. The principal and interest are 97-98% reinsured by the U.S. Department of Education and the collateral ratios range from 102% to 115%. Securities with a par value of \$8.5 million are rated AAA/Aaa, and a security with a par value of \$2.4 million is rated AAA/A3. These investments have experienced failed auctions beginning in February 2008. The investments in ARS will not be accessible until a successful auction occurs, they are restructured into a more liquid security, a buyer is found outside of the auction process, or the underlying securities have matured.

As of April 2, 2011, there was insufficient observable market information for the ARS held by Intevac to determine the fair value. Therefore Level 3 fair values were estimated for these securities by incorporating assumptions that market participants would use in their estimates of fair value. At April 2, 2011, the fair value of the ARS was

estimated at \$10.3 million based on a valuation by Houlihan Capital Advisors, LLC using discounted cash flow models and management applying internal analysis to the valuation. The estimates of future cash flows are based on certain key assumptions, such as discount rates appropriate for the type of asset and risk, which are significant unobservable inputs. Some of these assumptions included credit quality, collateralization, final stated

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

maturity, estimates of the probability of being called or becoming liquid prior to final maturity, redemptions of similar ARS, previous market activity for the same investment security, impact due to extended periods of maximum auction rates and valuation models. These securities are classified as long-term assets, as management believes that the ARS market will not become liquid within the next year. Potentially, it could take until the final maturity of the underlying notes (ranging from 20 years to 35 years) to realize these investments recorded values.

Management believes that the impairment of the ARS investments is temporary, primarily due to the government guarantee of the underlying securities and Intevac's ability to hold these securities for the foreseeable future. Management believes that it is more likely than not that it would not be required to sell these securities before the recovery of their par amounts. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders' equity. Such an unrealized loss does not reduce net income for the applicable accounting period, because the loss is not viewed as other-than-temporary. The factors evaluated to differentiate between temporary and other-than-temporary include the projected future cash flows, credit ratings actions, and assessment of the credit quality of the underlying collateral. Factors considered in determining whether a loss is temporary include length of time and the extent to which the investment's fair value has been less than the cost basis, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer, and Intevac's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery of fair value. As of April 2, 2011, management has no reason to believe that any of the underlying issuers of Intevac's ARS or their insurers are presently at risk or that the underlying credit quality of the assets backing Intevac's ARS has been impacted by the reduced liquidity of these investments. As of April 2, 2011, based on the Level 3 valuation performed, Intevac determined that there was a temporary decline in fair value of its ARS of \$619,000.

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

The following table represents the fair value hierarchy of Intevac's assets and liabilities measured at fair value on a recurring basis as of April 2, 2011.

	<b>Fair Value Measurements at April 2, 2011</b>			
	<b>Total</b>	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>
	<b>(In thousands)</b>			
<b>Assets:</b>				
Money market funds	\$ 3,788	\$ 3,788	\$	\$
U.S. treasury and agency securities	21,481	7,987	13,494	
Commercial paper	22,241		22,241	
Corporate bonds and medium-term notes	34,512		34,512	
Municipal bonds	5,667		5,667	
VRDNs	11,375		11,375	
ARS	10,281			10,281
<b>Total assets</b>	<b>\$ 109,345</b>	<b>\$ 11,775</b>	<b>\$ 87,289</b>	<b>\$ 10,281</b>
<b>Liabilities:</b>				
Acquisition-related contingent consideration	\$ 10,157	\$	\$	\$ 10,157

The following table presents the changes in Level 3 instruments measured on a recurring basis for the three months ended April 2, 2011 and April 3, 2010. The majority of Intevac's Level 3 balances consist of investment securities classified as available-for-sale with changes in fair value recorded in stockholders' equity.

Changes in Level 3 instruments (in thousands):

	<b>Three months ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>
	<b>(In thousands)</b>	
Beginning balance	\$ 10,273	\$ 66,249
Net unrealized gains (losses) included in earnings		
Net unrealized gains (losses) included in other comprehensive income (loss)	8	(670)
Redemptions at par		(250)
<b>Ending balance</b>	<b>\$ 10,281</b>	<b>\$ 65,329</b>

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**9. Other Comprehensive Income**

The components of accumulated other comprehensive income at April 2, 2011 and December 31, 2010 were as follows:

	<b>April 2, 2011</b>	<b>December 31, 2010</b>
	<b>(In thousands)</b>	
Accumulated net unrealized holding loss on available-for-sale investments, net of tax	\$ (425)	\$ (408)
Foreign currency translation gains	672	663
Total accumulated other comprehensive income	\$ 247	\$ 255

The changes in the components of comprehensive income (loss) for the three months ended April 2, 2011 and April 3, 2010 were as follows:

	<b>Three months ended April 2, 2011</b>		<b>April 3, 2010</b>	
	<b>(In thousands)</b>			
Net income (loss)	\$ (7,031)		\$ 1,430	
Unrealized holding gains (losses) on available-for-sale investments, net of taxes:				
Increase in unrealized holding losses		(26)		(670)
Income tax benefit		9		234
Foreign currency translation gains		(17)		(436)
		9		20
Total comprehensive income (loss)	\$ (7,039)		\$ 1,014	

**10. Net Income (Loss) Per Share**

The following table sets forth the computation of basic and diluted income (loss) per share:

	<b>Three months ended April 2, 2011</b>		<b>April 3, 2010</b>	
	<b>(In thousands)</b>			
Net income (loss)	\$ (7,031)		\$ 1,430	
Weighted-average shares basic	22,727		22,196	
Effect of dilutive potential common shares			779	
Weighted-average shares diluted	22,727		22,975	



Net income (loss) per share basic	\$ (0.31)	\$ 0.06
Net income (loss) per share diluted	\$ (0.31)	\$ 0.06
Antidilutive shares based on employee awards excluded	1,793	1,155

Potentially dilutive common shares consist of shares issuable upon exercise of employee stock options, and are excluded from the calculation of diluted EPS when their effect would be anti-dilutive.

Table of Contents

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**11. Segment Reporting**

Intevac's two reportable segments are Equipment and Intevac Photonics. Intevac's chief operating decision-maker has been identified as the President and CEO, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon Intevac's management organization structure as of April 2, 2011 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed.

Each reportable segment is separately managed and has separate financial results that are reviewed by Intevac's chief operating decision-maker. Each reportable segment contains closely related products that are unique to the particular segment. Segment operating profit is determined based upon internal performance measures used by the chief operating decision-maker.

Intevac derives the segment results from its internal management reporting system. The accounting policies Intevac uses to derive reportable segment results are substantially the same as those used for external reporting purposes. Management measures the performance of each reportable segment based upon several metrics, including orders, net revenues and operating income. Management uses these results to evaluate the performance of, and to assign resources to, each of the reportable segments. Intevac manages certain operating expenses separately at the corporate level. Intevac allocates certain of these corporate expenses to the segments in an amount equal to 3% of net revenues. Segment operating income excludes interest income/expense and other financial charges and income taxes according to how a particular reportable segment's management is measured. Management does not consider impairment charges and unallocated costs in measuring the performance of the reportable segments.

The Equipment segment designs, develops and markets manufacturing equipment and solutions to the hard disk drive industry and offers high-productivity technology solutions to the PV and semiconductor industries. Historically, the majority of Intevac's revenue has been derived from the Equipment segment and Intevac expects that the majority of its revenues for at least the next several years will continue to be derived from the Equipment segment.

The Intevac Photonics segment develops compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and the optical analysis of materials. Intevac provides sensors, cameras and systems for government applications such as night vision and long-range target identification and for commercial applications in the inspection, law enforcement, scientific and medical industries.

Information for each reportable segment for the three months ended April 2, 2011 and April 3, 2010 is as follows:

***Net Revenues***

	<b>Three months ended</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>
	<b>(In thousands)</b>	
Equipment	\$ 10,180	\$ 25,557
Intevac Photonics	7,243	7,585
Total segment net revenues	\$ 17,423	\$ 33,142

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

**Operating Income (Loss)**

	<b>Three months ended</b>	
	<b>April</b>	<b>April 3,</b>
	<b>2,</b>	<b>2010</b>
	<b>2011</b>	<b>2010</b>
	<b>(In thousands)</b>	
Equipment	\$ (6,270)	\$ 3,880
Intevac Photonics	(1,583)	(1,184)
Total income (loss) from segment operations	(7,853)	2,696
Unallocated costs	(1,664)	(1,329)
Income (loss) from operations	(9,517)	1,367
Interest income, net	246	405
Other income and expense, net	(117)	(14)
Income (loss) before income taxes	\$ (9,388)	\$ 1,758

Total assets for each reportable segment as of April 2, 2011 and December 31, 2010 are as follows:

**Assets**

	<b>April 2,</b>	<b>December</b>
	<b>2011</b>	<b>31,</b>
		<b>2010</b>
	<b>(In thousands)</b>	
Equipment	\$ 52,702	\$ 57,130
Intevac Photonics	29,053	31,275
Total segment assets	81,755	88,405
Cash, cash equivalents and investments	128,436	137,380
Deferred income taxes	19,720	17,718
Other current assets	6,421	5,889
Common property, plant and equipment	1,826	1,803
Other assets	618	576
Consolidated total assets	\$ 238,776	\$ 251,771

**12. Income Taxes**

Intevac recorded an income tax benefit at an effective rate of 25.3% for the three months ended April 2, 2011, compared with an income tax provision at an effective rate of 16.5% for the three months ended April 3, 2010. Intevac adjusts its effective income tax rate each quarter to be consistent with the estimated annual effective income tax rate. The effective income tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits, the effect of permanent differences and the geographical composition of Intevac's worldwide earnings. Intevac's effective income tax rate is highly dependent on the availability of tax credits and the geographic

composition of Intevac's worldwide earnings.

Intevac enjoys a tax holiday in Singapore through the tax years ending in 2015. The tax holiday provides a lower income tax rate on certain classes of income and the agreement requires that certain thresholds of business investment and employment levels be met in Singapore in order to maintain this holiday.

Intevac is subject to income taxes in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and

**Table of Contents**

**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
**(Unaudited)**

require significant judgment to apply. With few exceptions, Intevac is not subject to U.S. federal, state and local, or international jurisdictions income tax examinations by tax authorities for the years before 2006. Tax years 1999 through 2006 are subject to income tax examinations by U.S. federal and California tax authorities to the extent of tax credit carry forwards remaining or utilized in an otherwise open year. During the first quarter of fiscal 2011, the California income tax examination for fiscal years ended 2005, 2006 and 2007 was completed. Presently, there are no active income tax examinations in the jurisdictions where Intevac operates.

**13. Contingencies**

From time to time, Intevac may have certain contingent liabilities that arise in the ordinary course of its business activities. Intevac accounts for contingent liabilities when it is probable that future expenditures will be made and such expenditures can be reasonably estimated.

**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

This Quarterly Report on Form 10-Q contains forward-looking statements, which involve risks and uncertainties. Words such as believes, expects, anticipates and the like indicate forward-looking statements. These forward-looking statements include comments related to Intevac's shipments, projected revenue recognition, product costs, gross margin, operating expenses, interest income, income taxes, cash balances and financial results in 2011 and beyond; projected customer requirements for Intevac's new and existing products, and when, and if, Intevac's customers will place orders for these products; Intevac's ability to proliferate its Photonics technology into major military programs and to develop and introduce commercial imaging products; the timing of delivery and/or acceptance of the systems and products that comprise Intevac's backlog for revenue; legal proceedings; and internal controls. Intevac's actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under Risk Factors and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed on February 25, 2011, and our periodic Form 10-Q's and Form 8-K's.

**Overview**

Intevac provides process manufacturing equipment solutions to the hard disk drive industry, high-productivity process manufacturing equipment and inspection solutions to the photovoltaic ( PV ) industry and wafer handling platforms to the semiconductor industry. Intevac also provides sensors, cameras and systems for government applications such as night vision and long-range target identification and for commercial applications in the inspection, medical, scientific and security industries. Intevac's customers and potential customers include manufacturers of hard disk drives, semiconductor equipment, and PV cells as well as medical, scientific and security companies, law enforcement and the U.S. government and its agencies and contractors. Intevac reports two segments: Equipment and Intevac Photonics. During the fourth quarter of 2010, Intevac completed the acquisition of the outstanding shares of Solar Implant Technologies, Inc. ( SIT ), a privately-owned, development-stage company, creating a manufacturing module for PV applications.

Product development and manufacturing activities occur in North America and Asia. Intevac has field offices in Asia to support its equipment customers. Intevac's equipment and service products are highly technical and, with the exception of Japan, are sold primarily through a direct sales force. In Japan, sales are typically made by Intevac's Japanese distributor, Matsubo.

Intevac's results are driven primarily by worldwide demand for hard disk drives, which in turn depends on end-user demand for personal computers, enterprise data storage, personal audio and video players and video game platforms. Intevac continues to execute its equipment diversification strategy into new markets by introducing products for PV solar cell and semiconductor equipment manufacturing. Intevac believes that expansion into these new markets which are significantly larger than the hard disk drive deposition equipment market will result in incremental equipment revenues for Intevac and decrease Intevac's dependence on the hard disk drive industry. Intevac's business is subject to cyclical industry conditions, as demand for manufacturing equipment and services can change depending on supply and demand for hard disk drives, semiconductors, and PV cells, as well as other factors, such as global economic conditions and technological advances in fabrication processes.

**Table of Contents**

The following table presents certain significant measurements for the three months ended April 2, 2011 and April 3, 2010:

	<b>Three months ended</b>		<b>Change over prior period</b>
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	
	<b>(In thousands, except percentages and per share amounts)</b>		
Net revenues	\$ 17,423	\$ 33,142	\$ (15,719)
Gross profit	\$ 6,380	\$ 14,478	\$ (8,098)
Gross margin percent	36.6%	43.7%	(7) points
Net income (loss)	\$ (7,031)	\$ 1,430	\$ (8,461)
Earnings (loss) per diluted share	\$ (0.31)	\$ 0.06	\$ (0.37)

First quarter financial results for fiscal 2011 declined as Intevac's Equipment customers did not take delivery of any 200 Lean systems. Net sales decreased during the first quarter of fiscal 2011 primarily due to lower equipment sales to disk manufacturers and lower Intevac Photonics' technology development contracts offset in part by higher Intevac Photonics product sales. Net income for the first quarter of fiscal 2011 decreased compared to the same period in the prior year due to lower net sales, increased operating expenses from the inclusion of SIT which was acquired in the fourth quarter of fiscal 2010, offset in-part by the absence of variable compensation expenses and recognition of an income tax benefit. In the first quarter of fiscal 2011, the Company did not record variable compensation expenses as a result of being in a loss position.

For the second quarter of 2011, Intevac expects its Equipment revenue to be higher than the first quarter of 2011 as hard disk drive customers take delivery of systems currently in backlog to increase their production capacity. Intevac expects Intevac Photonics' revenues in the second quarter of 2011 to increase from the first quarter of 2011 as Photonics continues to increase its digital night-vision product shipments and penetrate new military program opportunities.

Intevac's trademarks, include the following: 200 Lean<sup>®</sup>, AccuLuber<sup>®</sup>, Continuum<sup>®</sup>, DEBAPS<sup>®</sup>, ExaminerR<sup>®</sup>, I-Port<sup>®</sup>, LEAN SOLAR<sup>®</sup>, LithoPrime<sup>®</sup>, LITHONANO<sup>®</sup>, NanoVista<sup>®</sup>, Night Vision<sup>®</sup>, Night Port<sup>®</sup>, PHARMA-ID<sup>®</sup>, and RAPID-ID<sup>®</sup>.

**Results of Operations***Net revenues*

	<b>Three months ended</b>		<b>Change over prior period</b>	
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>Amount</b>	<b>%</b>
	<b>(In thousands, except percentages)</b>			
Equipment	\$ 10,180	\$ 25,557	\$ (15,377)	(60.2)%
Intevac Photonics	7,243	7,585	(342)	(4.5)%
Total net revenues	\$ 17,423	\$ 33,142	\$ (15,719)	(47.4)%

**Table of Contents**

Equipment revenue for the three months ended April 2, 2011 included revenue recognized for three AccuLuber™ systems, disk equipment technology upgrades and spare parts. Equipment revenue for the three months ended April 3, 2010 included revenue recognized for two 200 Lean systems, one AccuLuber system, disk equipment technology upgrades and spare parts. Equipment revenue for the three months ended April 2, 2011 did not include any sales of 200 Lean systems. Intevac expects to ship fewer 200 Lean systems in 2011 compared to 2010 as the hard disk drive industry is not expected to add the same level of capacity experienced in 2010. Demand for hard disk drives in the long term is expected to increase driven by the need for corporations to replace and update employee computers, increased information technology spending, growth in digital storage and the proliferation of personal computers into emerging economies.

Intevac Photonics revenue for the three months ended April 2, 2011 consisted of \$1.9 million of research and development contract revenue and \$5.3 million of product sales. Intevac Photonics revenue for the three months ended April 3, 2010 consisted of \$4.2 million of research and development contract revenue and \$3.4 million of product sales. The increase in product revenue resulted from higher sales of digital night-vision cameras and commercial products. The decrease in contract research and development revenue was the result of a lower volume of contracts as several of Intevac Photonics' large development contracts were completed in 2010 and delays in U.S. government defense budget approvals. Intevac expects that in 2011, Intevac Photonics business levels will be flat compared to fiscal 2010. For fiscal 2011, Intevac expects Photonics product revenue from low-light sensors and cameras to increase; however, contract research and development revenue will likely be lower as a result of the completion of certain development contracts in fiscal 2010 and delayed contract funding for several large programs due to delays in U.S. government defense budget approvals. Substantial growth in future Intevac Photonics revenues is dependent on proliferation of Intevac's technology into major military programs, continued defense spending, the ability to obtain export licenses for foreign customers, obtaining production subcontracts for these programs, and development and sale of additional commercial products.

Intevac's backlog of orders at April 2, 2011 was \$41.7 million, as compared to \$46.7 million at December 31, 2010 and \$152.3 million at April 3, 2010. The \$41.7 million of backlog at April 2, 2011 consisted of \$25.1 million of Equipment backlog and \$16.6 million of Intevac Photonics backlog. The \$46.7 million of backlog at December 31, 2010 consisted of \$27.3 million of Equipment backlog and \$19.4 million of Intevac Photonics backlog. Backlog at April 2, 2011 included two 200 Lean systems compared to two at December 31, 2010 and twenty-six at April 3, 2010.

International sales decreased by 40.1% to \$10.3 million for the three months ended April 2, 2011 from \$17.2 million for the three months ended April 3, 2010. International sales include products shipped to overseas operations of U.S. companies. The decrease in international sales was primarily due to a decrease in net revenues from disk sputtering systems and upgrades. Substantially all of Intevac's international sales are to customers in Asia. International sales constituted 59.0% of net revenues for the three months ended April 2, 2011 and 51.8% of net revenues for the three months ended April 3, 2010. The mix of domestic versus international sales will change from period to period depending on the location of Intevac's largest customers in each period.

*Gross profit*

	<b>Three months ended</b>		
	<b>April 2, 2011</b>	<b>April 3, 2010</b>	<b>% Change</b>
	<b>(In thousands, except percentages)</b>		
Equipment gross profit	\$4,608	\$12,453	(63.0)%
% of Equipment net revenues	45.3%	48.7%	
Intevac Photonics gross profit	\$1,772	\$2,025	(12.5)%
% of Intevac Photonics net revenues	24.5%	26.7%	
Total gross profit	\$6,380	\$14,478	(55.9)%
% of net revenues	36.6%	43.7%	





**Table of Contents**

Cost of net revenues consists primarily of purchased materials and costs attributable to contract research and development, and also includes fabrication, assembly, test and installation labor and overhead, customer-specific engineering costs, warranty costs, royalties, provisions for inventory reserves and scrap.

Equipment gross margin was 45.3% in the three months ended April 2, 2011 compared to 48.7% in the three months ended April 3, 2010. The lower gross margin was due primarily to lower revenues, product mix, and lower factory utilization. Gross margins in the Equipment business will vary depending on a number of factors, including revenue levels, product mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

Intevac Photonics gross margin was 24.5% in the three months ended April 2, 2011 compared to 26.7% in the three months ended April 3, 2010. The decrease in gross margin resulted primarily from lower revenues, lower margins on technology development contracts and a charge for inventory write-offs offset in part by favorable product mix to higher margin product sales and cost reductions associated with Intevac Photonics high-volume production contract for its digital night-vision camera with a NATO customer.

*Research and development*

	Three months ended		Change over prior period	
	April 2, 2011	April 3, 2010	Amount	%
	(In thousands, except percentages)			
Research and development expense	\$9,012	\$6,544	\$2,468	37.7%
% of net revenues	51.7%	19.7%		

Research and development spending increased in both Equipment and Intevac Photonics during the three months ended April 2, 2011 as compared to the three months ended April 3, 2010. The increase in Equipment spending was due primarily to increased PV development and the inclusion of SIT which was acquired in the fourth quarter of fiscal 2010. The increase in Intevac Photonics research and development reflected a lower volume of billable contract research and development efforts. Research and development expenses do not include costs of \$1.4 million and \$2.8 million for the three-month periods ended April 2, 2011 and April 3, 2010, respectively, which are related to Intevac Photonics contract research and development and included in cost of net revenues.

*Selling, general and administrative*

	Three months ended		Change over prior period	
	April 2, 2011	April 3, 2010	Amount	%
	(In thousands, except percentages)			
Selling, general and administrative expense	\$6,885	\$6,567	\$318	4.8%
% of net revenues	39.5%	19.8%		

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs. The increase in selling, general and administrative spending in the three months ended April 2, 2011 was primarily the result of acquisition-related charges and increased equity compensation expense, offset in part by the suspension of variable compensation accruals. Selling, general and administrative expense for the three months ended April 2, 2011 includes \$300,000 in charges associated with the change in the fair value of the contingent consideration obligations related to the SIT acquisition.

**Table of Contents***Interest income and other, net*

	Three months ended		Change over prior period	
	April 2, 2011	April 3, 2010	Amount	%
	(In thousands, except percentages)			

Interest income and other, net	\$ 129	\$ 391	\$(262)	(67.0)%
--------------------------------	--------	--------	---------	---------

Interest income and other, net consists primarily of interest income on investments and foreign currency gains and losses. The decrease in interest and other income in the three months ended April 2, 2011 resulted from lower interest rates and fluctuations in foreign currency gains and losses.

*Income tax provision (benefit)*

	Three months ended		Change over prior period	
	April 2, 2011	April 3, 2010	Amount	%
	(In thousands, except percentages)			

Income tax provision (benefit)	\$(2,357)	\$ 328	\$(2,685)	(818.6)%
--------------------------------	-----------	--------	-----------	----------

Intevac recorded an income tax benefit at an effective rate of 25.3% for the three months ended April 2, 2011, compared with an income tax provision at an effective rate of 16.5% for the three months ended April 3, 2010. Intevac adjusts its effective income tax rate each quarter to be consistent with the estimated annual effective income tax rate. The effective income tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits, the effect of permanent differences and the geographical composition of Intevac's worldwide earnings. Intevac's effective income tax rate is highly dependent on the availability of tax credits and the geographic composition of Intevac's worldwide earnings.

Intevac enjoys a tax holiday in Singapore through the tax years ending in 2015. The tax holiday provides a lower income tax rate on certain classes of income and the agreement requires that certain thresholds of business investment and employment levels be met in Singapore in order to maintain this holiday.

**Liquidity and Capital Resources**

At April 2, 2011, Intevac had \$128.4 million in cash, cash equivalents, and investments compared to \$137.4 million at December 31, 2010. During the first three months of 2011, cash and cash equivalents and investments decreased by \$8.9 million due primarily to cash used by operating activities and purchases of fixed assets partially offset by cash received from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

Cash, cash-equivalents and investments consist of the following:

	April 2, 2011	December 31, 2010
	(In thousands)	
Cash and cash equivalents	\$ 25,879	\$ 109,520
Short-term investments	50,263	4,994
Long-term investments	52,294	22,866
Total cash, cash equivalents and investments	\$ 128,436	\$ 137,380

Operating activities used cash of \$7.6 million during the first three months of 2011 and generated cash of \$23.3 million during the first three months of 2010. The decrease in cash generated by operating activities was due primarily to the net loss and changes in working capital during the first three months of 2011.

**Table of Contents**

Accounts receivable totaled \$17.6 million at April 2, 2011, compared to \$25.9 million at December 31, 2010. The decrease of \$8.4 million in the receivable balance was due to collection of system invoices. Total net inventories increased to \$21.8 million at April 2, 2011, compared to \$20.7 million at December 31, 2010 as the Company began building systems for delivery in the second quarter of fiscal 2011. Accounts payable decreased to \$5.1 million at April 2, 2011 compared to \$5.6 million at December 31, 2010 in line with business levels. Accrued payroll and related liabilities decreased by \$6.8 million during the three months ended April 2, 2011 primarily related to the payment for prior year bonuses and profit sharing.

Investing activities in the first three months of 2011 used cash of \$77.6 million. Purchases of investments net of proceeds from sales of investments totaled \$74.9 million. Capital expenditures for the three months ended April 2, 2011 were \$2.6 million.

Financing activities in the first three months of 2011 generated cash of \$1.5 million from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

Intevac's investment portfolio consists principally of investment grade money market mutual funds, U.S. Treasury and agency securities, commercial paper, municipal bonds, corporate bonds and variable rate demand notes (VRDNs). Intevac regularly monitors the credit risk in its investment portfolio and takes measures, which may include the sale of certain securities, to manage such risks in accordance with its investment policies.

As of April 2, 2011, Intevac's available-for-sale securities included \$10.9 million par value of auction rate securities (ARS), less a temporary valuation adjustment of \$619,000 to reflect their current lack of liquidity. Management believes that the impairment of the ARS investments is temporary. Due to current market conditions, these investments have experienced failed auctions beginning in mid-February 2008. These failed auctions result in a lack of liquidity in the securities, but do not affect the underlying collateral of the securities. Intevac does not anticipate that any potential lack of liquidity in these ARS will affect its ability to finance its operations and planned capital expenditures. Intevac continues to monitor efforts by the financial markets to find alternative means for restoring the liquidity of these investments. These investments are classified as non-current assets until Intevac has better visibility as to when their liquidity will be restored. The classification and valuation of these securities will continue to be reviewed quarterly.

As described in Note 8 of Notes to Condensed Consolidated Financial Statements, at April 2, 2011, the fair value of the ARS was estimated at \$10.3 million based on a valuation by Houlihan Capital Advisors, LLC, using discounted cash flow models and applying management's internal analysis to the valuation. The estimates of future cash flows are based on certain key assumptions, such as discount rates appropriate for the type of asset and risk, which are significant unobservable inputs. As of April 2, 2011, there was insufficient observable market information for the ARS held by Intevac to determine the fair value. Therefore Level 3 fair values were estimated for these securities by incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included credit quality, collateralization, final stated maturity, estimates of the probability of being called or becoming liquid prior to final maturity, redemptions of similar ARS, previous market activity for the same investment security, impact due to extended periods of maximum auction rates and valuation models.

Intevac believes that its existing cash, cash equivalents and investments will be sufficient to meet its cash requirements for the foreseeable future. Intevac intends to undertake approximately \$5 to \$6 million in capital expenditures during the remainder of 2011.

**Critical Accounting Policies and Estimates**

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America (US GAAP) requires management to make judgments, assumptions and estimates that affect the amounts reported. Intevac's significant accounting policies are described in Note 1 to the consolidated financial statements included in Item 8 of Intevac's Annual Report on Form 10-K filed on February 25, 2011. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

**Table of Contents**

A critical accounting policy is defined as one that is both material to the presentation of Intevac's financial statements and requires management to make difficult, subjective or complex judgments that could have a material effect on Intevac's financial conditions and results of operations. Specifically, critical accounting estimates have the following attributes: 1) Intevac is required to make assumptions about matters that are highly uncertain at the time of the estimate; and 2) different estimates Intevac could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on Intevac's financial condition or results of operations.

Estimates and assumptions about future events and their effects cannot be determined with certainty. Intevac bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as Intevac's operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they become known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. Many of these uncertainties are discussed in the section below entitled Risk Factors. Based on a critical assessment of Intevac's accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that Intevac's consolidated financial statements are fairly stated in accordance with US GAAP, and provide a meaningful presentation of Intevac's financial condition and results of operation.

For further information about Intevac's other critical accounting policies, see the discussion of critical accounting policies in Intevac's 2010 Form 10-K. Management believes that there has been no significant change during the three months ended April 2, 2011 to the items identified as critical accounting policies in Intevac's 2010 Form 10-K.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest rate risk.* Intevac's exposure to market risk for changes in interest rates relates primarily to its investment portfolio. Intevac does not use derivative financial instruments in Intevac's investment portfolio. Intevac places its investments with high quality credit issuers and, by policy, limits the amount of credit exposure to any one issuer. Investments typically consist of commercial paper, obligations of the U.S. government and its agencies, corporate debt securities, municipal bonds, VRDNs and ARS.

The table below presents principal amounts and related weighted-average interest rates by year of expected maturity for Intevac's investment portfolio at April 2, 2011.

	2011	2012	2013	2014	2015	Beyond	Total	Fair Value
	(In thousands, except percentages)							
Cash equivalents								
Fixed rate amounts	\$ 3,000						\$ 3,000	\$ 3,000
Weighted-average rate	0.31%							
Variable rate amounts	\$ 3,788						\$ 3,788	\$ 3,788
Weighted-average rate	0.10%							
Short-term investments								
Fixed rate amounts	\$24,990	\$12,884					\$ 37,874	\$ 37,888
Weighted-average rate	0.68%	3.19%						
Variable rate amounts	\$12,375						\$ 12,375	\$ 12,375
Weighted-average rate	0.40%							
Long-term investments								
Fixed rate amounts		\$35,880	\$6,182			\$10,900	\$ 52,962	\$ 52,294
Weighted-average rate		2.82%	2.41%			3.38%		
Total investment portfolio	\$44,153	\$48,764	\$6,182			\$10,900	\$109,999	\$109,345

At April 2, 2011, Intevac held investments in ARS. With the liquidity issues experienced in global credit and capital markets, Intevac's ARS have experienced multiple failed auctions. Intevac continues to earn interest at the maximum contractual rate for each security. The estimated values of the ARS held by Intevac are no longer at par. As of April 2, 2011, Intevac had \$10.3 million in ARS in the Condensed Consolidated Balance Sheet, which is net of an unrealized loss of \$619,000. The unrealized loss is included in other comprehensive income, as the decline in value is deemed to be temporary due primarily to Intevac's ability and intent to hold these securities long enough to recover their values and that it is more likely than not that Intevac would not be required to sell these ARS before recovery in their par values.

Intevac continues to monitor the market for ARS and consider its impact (if any) on the fair market value of its investments. If the current market conditions continue, or the anticipated recovery in market values does not occur, Intevac may be required to record additional unrealized losses or record an impairment charge in 2011.

Based on Intevac's ability to access its cash, its expected operating cash flows, and other sources of cash, Intevac does not anticipate that the lack of liquidity of these investments will affect Intevac's ability to operate its business in the ordinary course.

*Foreign exchange risk.* From time to time, Intevac enters into foreign currency forward exchange contracts to economically hedge certain of anticipated foreign currency transaction, translation and re-measurement exposures. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on Intevac's operating results. At April 2, 2011, Intevac had no foreign currency forward exchange contracts.



**Table of Contents****Item 4. Controls and Procedures****Evaluation of disclosure controls and procedures**

Intevac maintains a set of disclosure controls and procedures that are designed to ensure that information relating to Intevac, Inc. required to be disclosed in periodic filings under the Securities Exchange Act of 1934, or Exchange Act, is recorded, processed, summarized and reported in a timely manner under the Exchange Act. In connection with the filing of this Form 10-Q for the quarter ended April 2, 2011, as required under Rule 13a-15(b) of the Exchange Act, an evaluation was carried out under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Intevac's disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, Intevac's Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of April 2, 2011.

Attached as exhibits to this Quarterly Report are certifications of the CEO and the CFO, which are required in accordance with Rule 13a-14 of the Exchange Act. This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

**Definition of disclosure controls**

Disclosure Controls are controls and procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. Disclosure Controls are also designed to ensure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Our Disclosure Controls include components of our internal control over financial reporting, which consists of control processes designed to provide reasonable assurance regarding the reliability of our financial reporting and the preparation of financial statements in accordance with generally accepted accounting principles in the U.S. To the extent that components of our internal control over financial reporting are included within our Disclosure Controls, they are included in the scope of our quarterly controls evaluation.

**Limitations on the effectiveness of controls**

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

**Changes in internal controls over financial reporting**

There were no changes in our internal controls over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, Intevac's internal control over financial reporting.

**Table of Contents****PART II. OTHER INFORMATION****Item 1. Legal Proceedings**

From time to time, Intevac is involved in claims and legal proceedings that arise in the ordinary course of business. Intevac expects that the number and significance of these matters will increase as Intevac's business expands. Any claims or proceedings against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, result in the diversion of significant operational resources, or require us to enter into royalty or licensing agreements which, if required, may not be available on terms favorable to us or at all. Intevac is not presently a party to any lawsuit or proceeding that, in Intevac's opinion, is likely to seriously harm Intevac's business.

**Item 1A. Risk Factors**

The following factors could materially affect Intevac's business, financial condition or results of operations and should be carefully considered in evaluating the Company and its business, in addition to other information presented elsewhere in this report.

***The industries we serve are cyclical, volatile and unpredictable.***

The majority of our revenue is derived from the sale of equipment used to manufacture commodity technology products such as disk drives. We have also entered markets to sell equipment used to manufacture commodity technology products such as semiconductor devices and photovoltaic ( PV ) solar cells. This subjects us to business cycles, the timing, length and volatility of which can be difficult to predict. When demand for commodity technology products exceeds production capacity, then demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of commodity technology products exceeds demand, then demand for new capital equipment such as ours tends to be depressed. For example, sales of systems for magnetic disk production were severely depressed from mid-1998 until mid-2003 and grew rapidly from 2004 through 2006, followed by a downturn in the cycle in late 2007 which continued through 2009. The number of new systems delivered declined sequentially in 2007, 2008 and 2009. The number of new systems delivered increased in 2010 as customers increased their production capacity in response to increased demand for digital storage. Intevac expects to ship fewer 200 Lean systems in 2011 compared to 2010 as the hard disk drive industry is not expected to add the same level of capacity experienced in 2010. We cannot predict with any certainty when these cycles will begin or end.

Our equipment represents only a portion of the capital expenditure that our customers incur when they upgrade or add production capacity. Accordingly, our customers generally commit to making large capital expenditures, far in excess of the cost of our systems alone, when they decide to purchase our systems. The magnitude of these capital expenditures requires our customers to have access to large amounts of capital. The magnetic disk, semiconductor and solar cell manufacturing industries have from time to time made significant additions to their production capacity. Our customers generally reduce their level of capital investment during downturns in the overall economy, or during a downturn in their industries.

We must effectively manage our resources and production capacity to meet rapidly changing demand. Our business experiences rapid growth and contraction, which stresses our infrastructure, internal systems and managerial resources. During periods of increasing demand for our products, we must have sufficient manufacturing capacity and inventory to meet customer demand; attract, retain and motivate a sufficient number of qualified individuals; and effectively manage our supply chain. During periods of decreasing demand for our products, we must be able to align our cost structure with prevailing market conditions; motivate and retain key employees and effectively manage our supply chain.

**Table of Contents*****Sales of our equipment are primarily dependent on our customers' upgrade and capacity expansion plans and whether our customers select our equipment.***

We have no control over our customers' upgrade and capacity expansion plans, and we cannot be sure they will select, or continue to select, our equipment when they upgrade or expand their capacity. The sales cycle for our equipment systems can be a year or longer, involving individuals from many different areas of Intevac and numerous product presentations and demonstrations for our prospective customers. Our sales process also commonly includes production of samples, customization of our products, and installation of evaluation systems in the factories of our prospective customers. We do not enter into long-term contracts with our customers, and until an order is actually submitted by a customer there is no binding commitment to purchase our systems.

Intevac Photonics' business is also subject to long sales cycles because many of its products, such as our military imaging products, often must be designed into the customers' end products, which are often complex state-of-the-art products. These development cycles are often multi-year, and our sales are contingent on our customers successfully integrating our product into their product, completing development of their product and then obtaining production orders for their product from the U.S. government or its allies.

Sales of new manufacturing systems are also dependent on obsolescence and replacement of the installed base of our customers' existing equipment with newer, more capable equipment. If upgrades are developed that extend the useful life of the installed base of systems, then we tend to sell more upgrade products and fewer new systems, which can significantly reduce total revenue. For example, some of our 200 Lean customers continue to use legacy systems for the production of perpendicular media, which delayed the replacement of such systems with new 200 Lean systems.

Our 200 Lean customers also experience competition from companies that produce alternative storage technologies like flash memory, which offer smaller size, lower power consumption and more rugged designs. We expect that in the future, new personal computing devices and products will be developed, some of which, such as Internet appliances, iPad-like tablet computing devices, netbooks or mobile phones with advanced capabilities, or smartphones, may not contain a disk drive. Products using alternative technologies, such as flash memory, optical storage and other storage technologies, are becoming increasingly common and could become a significant source of competition to particular applications of the products of our 200 Lean customers, which could adversely affect our results of operations. If alternative technologies, such as flash memory, replace hard disk drives as a significant method of digital storage, then demand for our hard disk manufacturing products would decrease.

***We operate in an intensely competitive marketplace, and our competitors have greater resources than we do.***

In the market for our disk sputtering systems, we experience competition from Canon Anelva, which has sold a substantial number of systems worldwide. In the market for semiconductor wafer handling equipment we are attempting to enter a market with several large established competitors including Brooks Automation and Genmark Automation as well as competition from internally developed products at Applied Materials and Tokyo Electron. Intevac is attempting to enter the PV equipment market, and faces competition from large established competitors including Veeco Instruments, Centrotherm Photovoltaics, Roth & Rau, Von Ardenne and cell module manufacturers that are internally developing manufacturing equipment that may be sold externally in the future. In the market for our military imaging products we experience competition from companies such as ITT Industries and Fairchild Imaging (which was acquired by BAE Systems). In the markets for our commercial imaging products we compete with companies such as Andor, Dalsa, E2V, Hamamatsu, Texas Instruments and Roper Industries for sensor and camera products, and with companies such as Ahura, B&W Tek, GE Security, Horiba Jobin Yvon, Ocean Optics, Renishaw, Thermo Scientific and Smiths Detection for Raman spectrometer products. Our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do, especially in the semiconductor and photovoltaic equipment markets where we have not previously offered products. We cannot ensure that our competitors will not develop enhancements to, or future generations of, competitive products that offer superior price or performance features. Likewise, we cannot ensure that new competitors will not enter our markets and develop such enhanced products. Moreover, competition for our customers is intense, and our competitors have historically offered substantial pricing concessions and incentives to attract our customers or retain their existing customers.



**Table of Contents*****We are exposed to risks associated with a highly concentrated customer base and industry consolidation.***

Historically, a significant portion of our revenue in any particular period has been attributable to sales of our disk sputtering systems to a limited number of customers. This concentration of customers can lead to extreme variability in revenue and financial results from period to period.

Industry consolidation can limit the number of potential customers for our products. Seagate acquired Maxtor in 2006 and announced in 2011 that it will acquire Samsung's hard disk drive business. Western Digital acquired Komag in 2007, Hoya's magnetic media operations in 2010 and announced in 2011 that it will acquire Hitachi Global Storage Technology. The concentration of our customer base may enable our customers to demand pricing and other terms unfavorable to Intevac, and makes us more vulnerable to changes in demand by a given customer. Orders from a relatively limited number of manufacturers have accounted for, and will likely continue to account for, a substantial portion of our revenues. The loss of one of these large customers, or delays in purchasing by them, could have a material and adverse effect on our revenues.

***Our growth depends on development of technically advanced new products and processes.***

We have invested heavily, and continue to invest, in the development of new products, such as our 200 Lean Gen II system, our Continuum wafer handling product, our LEAN SOLAR systems for PV applications, our digital night-vision products, our Raman system products and our near-eye display products. Our success in developing and selling new products depends upon a variety of factors, including our ability to: predict future customer requirements, make technological advances, achieve a low total cost of ownership for our products, introduce new products on schedule, manufacture products cost-effectively including transitioning production to volume manufacturing; commercialize and attain customer acceptance of our products; and achieve acceptable and reliable performance of our new products in the field. Our new product decisions and development commitments must anticipate continuously evolving industry requirements significantly in advance of sales. In addition, we are attempting to expand into new or related markets, including the semiconductor market for wafer fabrication equipment and the PV market. Our expansion into the PV market is dependent upon the success of our customers' development plans, some of which are start-ups and in their preliminary stages of development, as well as their ability to raise capital to fund their future development and capacity expansion. To date Intevac has not recognized revenue from our semiconductor wafer handling or PV manufacturing products. Failure to correctly assess the size of the markets, to successfully develop cost effective products to address the markets or to establish effective sales and support of the new products would have a material adverse effect on future revenues and profits.

Rapid technological change in our served markets requires us to rapidly develop new technically advanced products. Our future success depends in part on our ability to develop and offer new products with improved capabilities and to continue to enhance our existing products. If new products have reliability or quality problems, our performance may be impacted by reduced orders, higher manufacturing costs, delays in acceptance and payment for new products and additional service and warranty expenses.

***Our operating results fluctuate significantly from quarter to quarter, which can lead to volatility in the price of our common stock.***

Our quarterly revenues and common stock price have fluctuated significantly. We anticipate that our revenues, operating margins and common stock price will continue to fluctuate for a variety of reasons, including: (1) changes in the demand, due to seasonality, cyclicality and other factors in the markets for computer systems, storage subsystems and consumer electronics containing disks our customers produce with our systems; (2) delays or problems in the introduction and acceptance of our new products, or delivery of existing products; (3) timing of orders, acceptance of new systems by our customers or cancellation of those orders; (4) new products, services or technological innovations by our competitors or us; (5) changes in our manufacturing costs and operating expense; (6) changes in general economic, political, stock market and industry conditions; and (7) any failure of our operating results to meet the expectations of investment research analysts or investors.

**Table of Contents**

Any of these, or other factors, could lead to volatility and/or a rapid change in the trading price of our common shares. In the past, securities class action litigation has been instituted against companies following periods of volatility in the market price of their securities. Any such litigation, if instituted against Intevac, could result in substantial costs and diversion of management time and attention.

***Adverse economic conditions and volatility and disruption of the capital and credit markets may negatively impact our revenues and our ability to access financing.***

Economic conditions worldwide have contributed to decreased spending by our customers and a slowdown in the hard disk drive industry. These factors have adversely impacted our operating results in prior periods, including most recently during fiscal 2009, and have caused us to be cautious about our future outlook. Although macroeconomic and global market conditions improved in the latter half of 2009 and during fiscal 2010, our customers continue to remain cautious as it relates to the sustainability of the recovery. Negative macroeconomic and global recessionary factors, further volatility or disruption in the capital and credit markets or further uncertainty or weakening in key markets could negatively impact spending for our products and may materially adversely affect our business, operating results and financial condition.

In addition, while we intend to finance operations with existing cash and cash flow from operations, if necessary, we may require financing to support our continued operations. Due to the existing uncertainty in the capital and credit markets, our access to capital may not be available on terms acceptable to us or at all.

***We may not be able to obtain export licenses from the U.S. government permitting delivery of our products to international customers.***

Many of our products, especially Intevac Photonics products, require export licenses from U.S. government agencies under the Export Administration Act, the Trading with the Enemy Act of 1917, the Arms Export Act of 1976 or the International Traffic in Arms Regulations. These regulations limit the potential market for some of our products. We can give no assurance that we will be successful in obtaining all the licenses necessary to export our products. Heightened government scrutiny of export licenses for defense related products has resulted in lengthened review periods for our license applications. Exports to countries that are not considered by the U.S. government to be allies are likely to be prohibited, and even sales to U.S. allies may be limited. Failure to comply with export control laws, including identification and reporting of all exports and re-exports of controlled technology or exports made without correct license approval or improper license use could result in severe penalties and revocation of licenses. Failure to obtain export licenses, delays in obtaining licenses, or revocation of previously issued licenses would prevent us from selling the affected products outside the United States and could negatively impact our results of operations.

***The Intevac Photonics business is dependent on U.S. government contracts, which are subject to fixed pricing, immediate termination and a number of procurement rules and regulations.***

We sell many of our imaging products and services directly to the U.S. government, as well as to prime contractors for various U.S. government programs. Funding of multi-year government programs is subject to congressional appropriations, and there is no guarantee that the U.S. government will make further appropriations, particularly given the U.S. government's recent focus on spending in other areas. Sales to the U.S. government and its prime contractors may also be affected by changes in procurement policies, budget considerations and political developments in the United States or abroad. For example, if the U.S. government is less focused on defense spending or there is a decrease in hostilities, demand for our products could decrease. The loss of funding for a government program would result in a loss of future revenues attributable to that program. The influence of any of these factors, which are beyond our control, could negatively impact our results of operations.

A significant portion of our U.S. government revenue is derived from fixed-price development and production contracts. Under fixed-price contracts, unexpected increases in the cost to develop or manufacture a product, whether due to inaccurate estimates in the bidding process, unanticipated increases in material costs, reduced production volumes, inefficiencies or other factors, are borne by us. We have experienced cost overruns in the past that have resulted in losses on certain contracts, and may experience additional cost overruns in the

**Table of Contents**

future. We are required to recognize the total estimated impact of cost overruns in the period in which they are first identified. Such cost overruns could have a material adverse effect on our results of operations.

Generally, government contracts contain provisions permitting termination, in whole or in part, without prior notice at the government's convenience upon the payment of compensation only for work done and commitments made at the time of termination. We cannot ensure that one or more of the government contracts under which we, or our customers, operate will not be terminated under these circumstances. Also, we cannot ensure that we, or our customers, would be able to procure new government contracts to offset the revenues lost as a result of any termination of existing contracts, nor can we ensure that we, or our customers, will continue to remain in good standing as federal contractors.

As a U.S. government contractor we must comply with specific government rules and regulations and are subject to routine audits and investigations by U.S. government agencies. If we fail to comply with these rules and regulations, the results could include: (1) reductions in the value of our contracts; (2) reductions in amounts previously billed and recognized as revenue; (3) contract modifications or termination; (4) the assessment of penalties and fines; and (5) suspension or debarment from government contracting or subcontracting for a period of time or permanently.

***Changes to our effective tax rate affect our results of operations.***

As a global company, we are subject to taxation in the United States and various other countries. Significant judgment is required to determine and estimate worldwide tax liabilities. Our future effective tax rate could be affected by: (1) changes in tax laws; (2) the allocation of earnings to countries with differing tax rates; (3) changes in worldwide projected annual earnings in current and future years; (4) accounting pronouncements; or (5) changes in the valuation of our deferred tax assets and liabilities. Although we believe our tax estimates are reasonable, there can be no assurance that any final determination will not be different from the treatment reflected in our historical income tax provisions and accruals, which could result in additional payments by Intevac.

Intevac enjoys a tax holiday in Singapore through the tax years ending in 2015. The tax holiday provides a lower income tax rate on certain classes of income and the agreement requires that certain thresholds of business investment and employment levels be met in Singapore in order to maintain this holiday. We may lose our eligibility for such benefits if, among other things, applicable requirements are not met or if Intevac incurs net losses for which it cannot claim a deduction. Loss of these tax benefits could result in our income in Singapore being taxed at the statutory rate of 17% instead of the agreed Pioneer Tax Holiday rate of 0%. A loss of all or part of these tax benefits would adversely affect our results of operations and cash flows.

We booked a significant tax benefit in both 2009 and 2008 based on management's belief that we could both carryback losses to years Intevac paid income taxes and carryforward tax credits to future years where we would generate taxable income. Intevac will need to generate approximately \$58 million of taxable income in order to realize the Federal deferred tax assets recorded as of April 2, 2011. If our expectations of future income are incorrect, we could be required to establish a valuation allowance against some or all of the deferred tax assets.

***Our success depends on international sales and the management of global operations.***

The majority of our revenues come from regions outside the United States. Most of our international sales are to customers in Asia, which includes products shipped to overseas operations of U.S. companies. We currently have manufacturing facilities in California, Wyoming and Singapore and international customer support offices in Singapore, China, and Malaysia. We expect that international sales will continue to account for a significant portion of our total revenue in future years. Certain of our suppliers are also located outside the United States.

Managing our global operations presents challenges including, but not limited to, those arising from: (1) global trade issues; (2) variations in protection of intellectual property and other legal rights in different countries; (3) concerns of U.S. governmental agencies regarding possible national commercial and/or security issues posed by growing manufacturing business in Asia; (4) fluctuation of interest rates, raw material costs, labor and

**Table of Contents**

operating costs, and exchange rates, including the weakening relative position of the U.S. dollar; (5) variations in the ability to develop relationships with suppliers and other local businesses; (6) changes in the laws and regulations of the United States, including export restrictions, and other countries, as well as their interpretation and application; (7) the need to provide technical and spares support in different locations; (8) political and economic instability; (9) cultural differences; (10) varying government incentives to promote development; (11) shipping costs and delays; (12) adverse conditions in credit markets; (13) variations in tariffs, quotas, tax codes and other market barriers; and (14) barriers to movement of cash.

We must regularly assess the size, capability and location of our global infrastructure and make appropriate changes to address these issues.

***We may be subject to additional impairment charges due to potential declines in the fair value of our assets.***

As a result of our acquisitions, we have significant goodwill and intangible assets on our balance sheet. We test goodwill and intangible assets for impairment on a periodic basis as required, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The events or changes that could require us to test our goodwill and intangible assets for impairment include: a significant reduction in our stock price, and as a result market capitalization, changes in our estimated future cash flows, as well as changes in rates of growth in our industry or in any of our reporting units. In the fourth quarter of 2008, we recorded an impairment charge of \$10.5 million for goodwill due to a decline in our market capitalization and certain purchased technology intangible assets due to lower revenue expectations. We will continue to evaluate the carrying value of our remaining goodwill and intangible assets and if we determine in the future that there is a potential further impairment in any of our reporting units, we may be required to record additional charges to earnings which could materially adversely affect our financial results and could also materially adversely affect our business. See Note 5 Business Combination, Goodwill and Purchased Intangible Assets, Net in the Notes to the Condensed Consolidated Financial Statements for additional information related to impairment of goodwill and intangible assets.

***The liquidity of our auction rate securities is impaired, which could impact our ability to meet cash requirements and require additional financing.***

At April 2, 2011, we held auction rate securities ( ARS ) with a par value of \$10.9 million. The market for these securities had historically been highly liquid, even though the ARS that we hold have underlying maturities ranging from 20 to 35 years. The liquidity was achieved through auctions, which occurred every 7 or 28 days depending on the security, in which the interest paid on each security was reset to current market rates. We never intended to hold these securities to maturity, but rather to use the auction feature to sell the securities as needed to provide liquidity. Since February 2008, all of these ARS auctions have failed. The ARS will continue to be illiquid until a successful auction process is reinstated, they are restructured into a more liquid security, or a buyer is found outside of the auction process. We do not know when, or if, this will occur. All of the ARS held by us are student loan structured issues, originated under the U.S. Department of Education's Federal Family Education Loan Program with principal and interest 97% - 98% reinsured by the U.S. Department of Education. As of April 2, 2011, all of these securities are currently rated investment grade but there is no assurance that these ARS will continue to be similarly rated in the future. As of April 2, 2011, securities with a par value of \$8.5 million are rated AAA/Aaa, and a security with a par value of \$2.4 million is rated AAA/A3. These securities are classified as long-term investments and we recorded a temporary impairment charge of \$619,000. If: (1) the issuers of the ARS are unable to successfully resume auctions; or (2) the issuers do not redeem the ARS; or (3) a liquid market for the ARS does not develop; or (4) the U.S. Department of Education fails to support its guaranty of the obligations; or (5) these or any other valuation metrics or processes change, then Intevac may be required to further adjust the carrying value of the ARS and/or record an other-than-temporary impairment charge. In addition, Intevac could, in such a situation require additional financing which might not be available on favorable terms, if at all.

***Our success is dependent on recruiting and retaining a highly talented work force.***

Our employees are vital to our success, and our key management, engineering and other employees are difficult to replace. We generally do not have employment contracts with our key employees. Further, we do not



**Table of Contents**

maintain key person life insurance on any of our employees. The expansion of high technology companies worldwide has increased demand and competition for qualified personnel, and has made companies increasingly protective of prior employees. It may be difficult for us to locate employees who are not subject to non-competition agreements and other restrictions.

The majority of our U.S. operations are located in California where the cost of living and of recruiting employees is high. Additionally, our operating results depend, in large part, upon our ability to retain and attract qualified management, engineering, marketing, manufacturing, customer support, sales and administrative personnel. Furthermore, we compete with industries such as the hard disk drive, semiconductor, and solar industries for skilled employees. Failure to retain existing key personnel, or to attract, assimilate or retain additional highly qualified employees to meet our needs in the future, could have a material and adverse effect on our business, financial condition and results of operations.

***We are dependent on certain suppliers for parts used in our products.***

We are a manufacturing business. Purchased parts constitute the largest component of our product cost. Our ability to manufacture depends on the timely delivery of parts, components and subassemblies from suppliers. We obtain some of the key components and subassemblies used in our products from a single supplier or a limited group of suppliers. If any of our suppliers fail to deliver quality parts on a timely basis, we may experience delays in manufacturing, which could result in delayed product deliveries, increased costs to expedite deliveries or develop alternative suppliers, or require redesign of our products to accommodate alternative suppliers. Some of our suppliers are thinly capitalized and may be vulnerable to failure given recent economic conditions.

***Our business depends on the integrity of our intellectual property rights.***

The success of our business depends upon the integrity of our intellectual property rights, and we cannot ensure that: (1) any of our pending or future patent applications will be allowed or that any of the allowed applications will be issued as patents or will issue with claims of the scope we sought; (2) any of our patents will not be invalidated, deemed unenforceable, circumvented or challenged; (3) the rights granted under our patents will provide competitive advantages to us; (4) other parties will not develop similar products, duplicate our products or design around our patents; or (5) our patent rights, intellectual property laws or our agreements will adequately protect our intellectual property or competitive position.

From time to time, we have received claims that we are infringing third parties' intellectual property rights or seeking to invalidate our rights. We cannot ensure that third parties will not in the future claim that we have infringed current or future patents, trademarks or other proprietary rights relating to our products. Any claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to us.

***We could be involved in litigation.***

From time to time we may be involved in litigation of various types, including litigation alleging infringement of intellectual property rights and other claims. Litigation is expensive, subjects us to the risk of significant damages and requires significant management time and attention and could have a material and adverse effect on our business, financial condition and results of operations.

***Difficulties in integrating past or future acquisitions could adversely affect our business.***

We have completed a number of acquisitions during our operating history. For example, in 2007, we acquired certain assets of DeltaNu, LLC and certain assets of Creative Display Systems, LLC, in 2008 we acquired certain assets of OC Oerlikon Balzers Ltd. and in 2010 we acquired the outstanding shares of Solar Implant Technologies, Inc. We have spent and may continue to spend significant resources identifying and pursuing future acquisition opportunities. Acquisitions involve numerous risks including: (1) difficulties in integrating the operations, technologies and products of the acquired companies; (2) the diversion of our

**Table of Contents**

management's attention from other business concerns; and (3) the potential loss of key employees of the acquired companies. Failure to achieve the anticipated benefits of the prior and any future acquisitions or to successfully integrate the operations of the companies we acquire could have a material and adverse effect on our business, financial condition and results of operations. Any future acquisitions could also result in potentially dilutive issuance of equity securities, acquisition- or divestiture-related write-offs or the assumption of debt and contingent liabilities.

***We use hazardous materials and are subject to risks of non-compliance with environmental and safety regulations.***

We are subject to a variety of governmental regulations relating to the use, storage, discharge, handling, emission, generation, manufacture, treatment and disposal of toxic or otherwise hazardous substances, chemicals, materials or waste. If we fail to comply with current or future regulations, such failure could result in suspension of our operations, alteration of our manufacturing process, or substantial civil penalties or criminal fines against us or our officers, directors or employees. Additionally, these regulations could require us to acquire expensive remediation or abatement equipment or to incur substantial expenses to comply with them.

***Business interruptions could adversely affect our operations.***

Our operations are vulnerable to interruption by fire, earthquake or other natural disaster, quarantines or other disruptions associated with infectious diseases, national catastrophe, terrorist activities, war, disruptions in our computing and communications infrastructure due to power loss, telecommunications failure, human error, physical or electronic security breaches and computer viruses, and other events beyond our control. We do not have a detailed disaster recovery plan. Despite our implementation of network security measures, our tools and servers may be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems and tools located at customer sites. Political instability could cause us to incur increased costs in transportation, make such transportation unreliable, increase our insurance costs or cause international currency markets to fluctuate. This same instability could have the same effects on our suppliers and their ability to timely deliver their products. In addition, we do not carry sufficient business interruption insurance to compensate us for all losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business and results of operations. For example, we self-insure earthquake risks because we believe this is the prudent financial decision based on the high cost of the limited coverage available in the earthquake insurance market. An earthquake could significantly disrupt our operations, most of which are conducted in California. It could also significantly delay our research and engineering effort on new products, most of which is also conducted in California. We take steps to minimize the damage that would be caused by business interruptions, but there is no certainty that our efforts will prove successful.

***We are required to evaluate our internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002, and any adverse results from such evaluation could result in a loss of investor confidence in our financial reports and have an adverse effect on our stock price.***

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, our management must perform evaluations of our internal control over financial reporting. Beginning in 2004, our Form 10-K has included a report by management of their assessment of the adequacy of such internal control. Additionally, our independent registered public accounting firm must publicly attest to the effectiveness of our internal control over financial reporting.

We have completed the evaluation of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Although our assessment, testing, and evaluation resulted in our conclusion that as of December 31, 2010, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. Ongoing compliance with this requirement is complex, costly and time-consuming. If Intevac fails to maintain effective internal control over financial reporting; our management does not timely assess the adequacy of such internal control; or our independent registered public accounting firm does not deliver an unqualified opinion as to the effectiveness of our internal control over financial reporting, then we could be subject to restatement of previously reported financial results, regulatory sanctions and a decline in the public's perception of Intevac, which could have a material and adverse effect on our business, financial condition and results of operations.

**Table of Contents**

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

None.

**Item 3. *Defaults upon Senior Securities***

None.

**Item 4. *(Removed and Reserved)***

**Item 5. *Other Information***

None.

**Item 6. *Exhibits***

The following exhibits are filed herewith:

Exhibit Number	Description
10.2	The Registrant's 2003 Employee Stock Purchase Plan, as amended
10.3	The Registrant's 2004 Equity Incentive Plan, as amended
23.2	Consent of Independent Valuation Firm
31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications Pursuant to U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

**Table of Contents**

SIGNATURES

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.

INTEVAC, INC.

Date: May 3, 2011

By: /s/ KEVIN FAIRBAIRN  
Kevin Fairbairn  
President, Chief Executive Officer and  
Director (Principal Executive Officer)

Date: May 3, 2011

By: /s/ JEFFREY ANDRESON  
Jeffrey Andreson  
Executive Vice President, Finance and  
Administration, Chief Financial Officer,  
Treasurer and Secretary  
(Principal Financial and Accounting  
Officer)