

INTEVAC INC  
Form 10-Q  
August 01, 2012  
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**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 June 30, 2012

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)

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**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 August 1, 2012, 23,462,359 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

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**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****INTEVAC, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

|   | <b>June 30,<br/>2012</b>                    | <b>December 31,<br/>2011</b> |
|---|---|------------------------------|
|   | <b>(Unaudited)</b>                          |                              |
|   | <b>(In thousands, except<br/>par value)</b> |                              |
| <b>ASSETS</b>   |   |                              |
| Current assets:   |   |                              |
| Cash and cash equivalents   | \$ 12,598                                   | \$ 23,560                    |
| Short-term investments  | 53,543                                      | 58,585                       |
| Trade, note and other accounts receivable, net of allowances of \$0 at June 30, 2012 and of \$41 at December 31, 2011 | 25,945                                      | 18,561                       |
| Inventories   | 19,761                                      | 18,070                       |
| Prepaid expenses and other current assets   | 8,418                                       | 7,114                        |
| Deferred income tax assets  | 2,493                                       | 2,202                        |
| Total current assets  | 122,758                                     | 128,092                      |
| Property, plant and equipment, net  | 13,911                                      | 14,449                       |
| Long-term investments   | 37,323                                      | 32,677                       |
| Goodwill  | 18,389                                      | 18,389                       |
| Other intangible assets, net of amortization of \$2,616 at June 30, 2012 and \$2,344 at December 31, 2011             | 6,169                                       | 6,441                        |
| Deferred income taxes and other long-term assets  | 27,176                                      | 25,773                       |
| Total assets  | \$ 225,726                                  | \$ 225,821                   |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>  |   |                              |
| Current liabilities:  |   |                              |
| Accounts payable  | \$ 5,839                                    | \$ 4,857                     |
| Accrued payroll and related liabilities   | 4,693                                       | 4,205                        |
| Other accrued liabilities   | 12,842                                      | 9,887                        |
| Customer advances   | 1,900                                       | 5,040                        |
| Total current liabilities   | 25,274                                      | 23,989                       |
| Other long-term liabilities   | 10,179                                      | 9,922                        |
| Stockholders' equity:   |   |                              |
| Common stock, \$0.001 par value   | 23  | 23                           |
| Additional paid-in capital  | 149,187                                     | 146,307                      |
| Accumulated other comprehensive income  | 551   | 414                          |
| Retained earnings   | 40,512                                      | 45,166                       |
| Total stockholders' equity  | 190,273                                     | 191,910                      |
| Total liabilities and stockholders' equity  | \$ 225,726                                  | \$ 225,821                   |

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Note: Amounts as of December 31, 2011 are derived from the December 31, 2011 audited consolidated financial statements.

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****INTEVAC, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

|   | Three Months Ended                       |                 | Six Months Ended |                 |
|---|--|-----------------|------------------|-----------------|
|   | June 30,<br>2012                         | July 2,<br>2011 | June 30,<br>2012 | July 2,<br>2011 |
|   | (Unaudited)                              |                 |                  |                 |
|   | (In thousands, except per share amounts) |                 |                  |                 |
| Net revenues:                               |  |                 |                  |                 |
| Systems and components                      | \$ 28,634                                | \$ 25,734       | \$ 43,402        | \$ 41,225       |
| Technology development                      | 3,157                                    | 1,851           | 5,705            | 3,783           |
| Total net revenues                          | 31,791                                   | 27,585          | 49,107           | 45,008          |
| Cost of net revenues:                       |  |                 |                  |                 |
| Systems and components                      | 15,266                                   | 16,440          | 24,086           | 26,053          |
| Technology development                      | 2,271                                    | 1,008           | 3,943            | 2,437           |
| Total cost of net revenues                  | 17,537                                   | 17,448          | 28,029           | 28,490          |
| Gross profit                                | 14,254                                   | 10,137          | 21,078           | 16,518          |
| Operating expenses:                         |  |                 |                  |                 |
| Research and development                    | 8,263                                    | 8,290           | 17,476           | 17,302          |
| Selling, general and administrative         | 6,669                                    | 6,508           | 13,442           | 13,394          |
| Total operating expenses                    | 14,932                                   | 14,798          | 30,918           | 30,696          |
| Gain on sale of mainframe technology        |  |                 | 2,207            |                 |
| Loss from operations                        | (678)                                    | (4,661)         | (7,633)          | (14,178)        |
| Interest income and other, net              | 48                                       | 169             | 420              | 298             |
| Loss before income taxes                    | (630)                                    | (4,492)         | (7,213)          | (13,880)        |
| Provision for (benefit from) income taxes   | 863                                      | (1,873)         | (2,559)          | (4,230)         |
| Net loss                                    | \$ (1,493)                               | \$ (2,619)      | \$ (4,654)       | \$ (9,650)      |
| Net loss per share:                         |  |                 |                  |                 |
| Basic and diluted                           | \$ (0.06)                                | \$ (0.11)       | \$ (0.20)        | \$ (0.42)       |
| Weighted average common shares outstanding: |  |                 |                  |                 |
| Basic and diluted                           | 23,265                                   | 22,851          | 23,241           | 22,789          |

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****INTEVAC, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

|   | <b>Three Months Ended</b>                       |                | <b>Six Months Ended</b> |                |
|---|---|----------------|-------------------------|----------------|
|   | <b>June 30,</b>                                 | <b>July 2,</b> | <b>June 30,</b>         | <b>July 2,</b> |
|   | <b>2012</b>                                     | <b>2011</b>    | <b>2012</b>             | <b>2011</b>    |
|   | <b>(Unaudited)</b>                              |                |                         |                |
|   | <b>(In thousands, except per share amounts)</b> |                |                         |                |
| Net loss  | \$ (1,493)                                      | \$ (2,619)     | \$ (4,654)              | \$ (9,650)     |
| Other comprehensive income (loss), before tax                     |   |                |                         |                |
| Change in unrealized net loss on available-for-sale investments   | 101   | 339            | 232                     | 313            |
| Foreign currency translation gains (losses)                       | (26)  | 7              | (14)                    | 16             |
| Other comprehensive income, before tax                            | 75  | 346            | 218                     | 329            |
| Income tax benefit related to items in other comprehensive income | (35)  | (119)          | (81)                    | (110)          |
| Other comprehensive income, net of tax                            | 40  | 227            | 137                     | 219            |
| Comprehensive loss  | \$ (1,453)                                      | \$ (2,392)     | \$ (4,517)              | \$ (9,431)     |

See accompanying notes to the condensed consolidated financial statements.

**Table of Contents****INTEVAC, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

|  | Six months ended |                  |
|--|------------------|------------------|
|  | June 30,<br>2012 | July 2,<br>2011  |
|  | (Unaudited)      |                  |
|  | (In thousands)   |                  |
| <b>Operating activities</b>  |                  |                  |
| Net loss   | \$ (4,654)       | \$ (9,650)       |
| Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities: |                  |                  |
| Depreciation and amortization  | 2,299            | 2,825            |
| Net amortization of investment premiums and discounts  | 758              | 571              |
| Net loss on sale of investments  | 210              | 150              |
| Equity-based compensation  | 1,998            | 2,046            |
| Change in the fair value of acquisition-related contingent consideration                         | 643              | 573              |
| Deferred income taxes  | (2,373)          | (4,738)          |
| Gain on sale of mainframe technology   | (2,207)          |                  |
| Gain on disposal of equipment  |                  | (109)            |
| Changes in operating assets and liabilities  | (7,108)          | (3,297)          |
| <b>Total adjustments</b>   | <b>(5,780)</b>   | <b>(1,979)</b>   |
| <b>Net cash and cash equivalents used in operating activities</b>                                | <b>(10,434)</b>  | <b>(11,629)</b>  |
| <b>Investing activities</b>  |                  |                  |
| Purchases of investments   | (32,987)         | (87,040)         |
| Proceeds from sales and maturities of investments  | 32,647           | 23,095           |
| Proceeds from sale of equipment  |                  | 241              |
| Proceeds from sale of mainframe technology   | 3,000            |                  |
| Purchases of leasehold improvements and equipment  | (1,667)          | (4,068)          |
| <b>Net cash and cash equivalents provided by (used in) investing activities</b>                  | <b>993</b>       | <b>(67,772)</b>  |
| <b>Financing activities</b>  |                  |                  |
| Payment of acquisition-related contingent consideration  | (2,389)          |                  |
| Net proceeds from issuance of common stock   | 882              | 1,755            |
| <b>Net cash and cash equivalents provided by (used in) financing activities</b>                  | <b>(1,507)</b>   | <b>1,755</b>     |
| Effect of exchange rate changes on cash and cash equivalents                                     | (14)             | 16               |
| <b>Net decrease in cash and cash equivalents</b>   | <b>(10,962)</b>  | <b>(77,630)</b>  |
| Cash and cash equivalents at beginning of period   | 23,560           | 109,520          |
| <b>Cash and cash equivalents at end of period</b>  | <b>\$ 12,598</b> | <b>\$ 31,890</b> |

See accompanying notes to the condensed consolidated financial statements.



**Table of Contents****INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****1. 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, 2011 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, 2011 (2011 Form 10-K). Intevac's results of operations for the three and six months ended June 30, 2012 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. Inventories**

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

|                  | June 30,<br>2012 | December 31,<br>2011 |
|------------------|------------------|----------------------|
|                  | (In thousands)   |                      |
| Raw materials    | \$ 11,479        | \$ 12,662            |
| Work-in-progress | 2,114            | 3,020                |
| Finished goods   | 6,168            | 2,388                |
|                  | \$ 19,761        | \$ 18,070            |

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

**3. Equity-Based Compensation**

At June 30, 2012, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan and the 2004 Equity Incentive Plan (the Plans) and the 2003 Employee Stock Purchase Plan (the ESPP). Intevac's stockholders approved all of these plans.

The Plans permit the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, restricted stock units (RSUs also referred to as performance units) and performance shares. During the three months ended June 30, 2012, Intevac granted 328,000 stock options with an estimated total grant-date fair value of \$1.3 million and 91,000 RSUs with an estimated total grant-date fair value of \$684,000. During the three months ended July 2, 2011, Intevac granted 514,000 stock options with an estimated total grant-date fair value of \$3.1 million, including 2,000 shares granted to a consultant with a grant date fair value of \$11,000. During the six months ended June 30, 2012, Intevac granted 379,000 stock options with an estimated total grant-date fair value of \$1.5 million and 98,000 RSUs with an estimated total grant-date fair value of \$745,000. During the six months ended July 2, 2011, Intevac granted 540,000 stock options with an estimated total grant-date fair value of \$3.3 million.



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

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. Under the terms of the ESPP, employees can choose to have up to 15% of their base earnings withheld to purchase Intevac common stock. During the six months ended June 30, 2012, Intevac granted purchase rights with an estimated total grant-date fair value of \$872,000. During the six months ended July 2, 2011, Intevac granted purchase rights with an estimated total grant-date fair value of \$1.3 million.

**Compensation Expense**

The effect of recording equity-based compensation for the three and six months ended June 30, 2012 and July 2, 2011 was as follows:

|   | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                 |
|---|---------------------------|----------------|-------------------------|-----------------|
|   | <b>June 30,</b>           | <b>July 2,</b> | <b>June 30,</b>         | <b>July 2,</b>  |
|   | <b>2012</b>               | <b>2011</b>    | <b>2012</b>             | <b>2011</b>     |
|   | <b>(In thousands)</b>     |                |                         |                 |
| Equity-based compensation by type of award: |                           |                |                         |                 |
| Stock options                               | \$ 587                    | \$ 761         | \$ 1,320                | \$ 1,492        |
| RSUs  | 17                        |                | 23                      |                 |
| Employee stock purchase plan                | 340                       | 323            | 655                     | 554             |
| <b>Total equity-based compensation</b>      | <b>944</b>                | <b>1,084</b>   | <b>1,998</b>            | <b>2,046</b>    |
| Tax effect on equity-based compensation     | (222)                     | (293)          | (501)                   | (562)           |
| <b>Net effect on net loss</b>               | <b>\$ 722</b>             | <b>\$ 791</b>  | <b>\$ 1,497</b>         | <b>\$ 1,484</b> |

Equity-based compensation expense is based on awards ultimately expected to vest and 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.

**Stock Options and ESPP**

The fair value of stock options and ESPP awards is estimated at the grant date using the Black-Scholes option valuation model. The determination of fair value of stock options and ESPP awards on the date of grant using an option-pricing model is affected by Intevac's 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.

The weighted-average estimated value of employee stock options granted during the three months ended June 30, 2012 and July 2, 2011 was \$3.83 per share and \$6.07 per share, respectively. The weighted-average estimated value of employee stock options granted during the six months ended June 30, 2012 and July 2, 2011 was \$3.92 per share and \$6.12 per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the ESPP during the six months ended June 30, 2012 and July 2, 2011 was \$3.49 and \$5.18 per share, respectively. No purchase rights were granted under the ESPP during either the three months ended June 30, 2012 or July 2, 2011. 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:



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

|                                     | <b>Three Months Ended</b> |                         | <b>Six Months Ended</b>  |                         |
|-------------------------------------|---------------------------|-------------------------|--------------------------|-------------------------|
|                                     | <b>June 30,<br/>2012</b>  | <b>July 2,<br/>2011</b> | <b>June 30,<br/>2012</b> | <b>July 2,<br/>2011</b> |
| <b>Stock Options:</b>               |                           |                         |                          |                         |
| Expected volatility                 | 63.58%                    | 64.69%                  | 63.81%                   | 64.70%                  |
| Risk free interest rate             | 0.69%                     | 1.77%                   | 0.74%                    | 1.78%                   |
| Expected term of options (in years) | 4.6                       | 4.8                     | 4.6                      | 4.8                     |
| Dividend yield                      | None                      | None                    | None                     | None                    |

|   | <b>Six Months Ended</b> |                     |
|---|-------------------------|---------------------|
|   | <b>June 30, 2012</b>    | <b>July 2, 2011</b> |
| <b>Stock Purchase Rights:</b>               |                         |                     |
| Expected volatility                         | 61.77%                  | 52.40%              |
| Risk free interest rate                     | 0.33%                   | 0.51%               |
| Expected term of purchase rights (in years) | 1.56                    | 1.23                |
| 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.

**RSUs**

RSUs are converted into shares of Intevac common stock upon vesting on a one-for-one basis. RSUs typically are scheduled to vest over four years. Vesting of RSUs is subject to the grantee's continued service with Intevac. The compensation expense related to these awards is determined using the fair market value of Intevac common stock on the date of the grant, and the compensation expense is recognized over the vesting period.

**4. Goodwill and Purchased Intangible Assets**

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 2011, Intevac performed its annual impairment analysis and the results of the analysis indicated that Intevac's goodwill and purchased intangible assets with an indefinite useful life were not impaired. At June 30, 2012, Intevac had a total of \$18.4 million of goodwill and \$4.1 million of indefinite-life intangible assets. At June 30, 2012, \$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 and six months ended June 30, 2012 was \$136,000 and \$272,000 respectively. As of June 30, 2012, future amortization expense is expected to be \$270,000 for the remainder of 2012, \$541,000 for 2013, \$363,000 for 2014, \$284,000 for 2015, \$281,000 for 2016 and \$310,000 thereafter. Intangible assets by segment are as follows: Equipment: \$5.4 million and Intevac Photonics: \$814,000.



**Table of Contents****INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****5. Acquisition-Related Contingent Consideration**

In connection with the acquisition of Solar Implant Technologies, Inc. (SIT) on November 19, 2010, 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. On July 21, 2011, April 12, 2012, and July 2, 2012, Intevac made payments in the amounts of \$2.4 million, \$2.4 million and \$956,000 to the selling shareholders for achievement of the first, second and third milestones. Intevac estimated the fair value of this contingent consideration on June 30, 2012 to be in the amount of \$1.7 million using a discounted cash flow model based on the probabilities that the remaining 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 on June 30, 2012 to be in the amount of \$5.3 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.

The fair value measurement of contingent consideration is based on significant inputs not observed in the market and thus represents a Level 3 measurement. 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 following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the three- and six month periods ended June 30, 2012 and July 2, 2011:

|                       | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|-----------------------|---------------------------|----------------|-------------------------|----------------|
|                       | <b>June</b>               |                | <b>June</b>             |                |
|                       | <b>30,</b>                | <b>July 2,</b> | <b>30,</b>              | <b>July 2,</b> |
|                       | <b>2012</b>               | <b>2011</b>    | <b>2012</b>             | <b>2011</b>    |
|                       | <b>(In thousands)</b>     |                |                         |                |
| Opening balance       | \$ 8,993                  | \$ 10,157      | \$ 8,715                | \$ 9,857       |
| Changes in fair value | 365                       | 273            | 643                     | 573            |
| Cash payments made    | (2,389)                   |                | (2,389)                 |                |
| Closing balance       | \$ 6,969                  | \$ 10,430      | \$ 6,969                | \$ 10,430      |

The following table displays the balance sheet classification of the contingent consideration liability account at June 30, 2012 and at December 31, 2011:

|   | <b>June 30,</b>       | <b>December 31,</b> |
|---|-----------------------|---------------------|
|   | <b>2012</b>           | <b>2011</b>         |
|   | <b>(In thousands)</b> |                     |
| Other accrued liabilities                                 | \$ 1,817              | \$ 3,942            |
| Other long-term liabilities                               | 5,152                 | 4,773               |
| <b>Total acquisition-related contingent consideration</b> | <b>\$ 6,969</b>       | <b>\$ 8,715</b>     |





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

The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the contingent consideration liability as of June 30, 2012. Significant increases or decreases in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement.

|  | Fair Value | Quantitative Information about Level 3 Fair Value Measurements at June 30, 2012 |  |                          |
|--|------------|---|--|--------------------------|
|  |            | Valuation Technique   | Unobservable Input                                   | Range (Weighted Average) |
| (In thousands, except for percentages) |            |   |  |                          |
| Milestone Payable                      | \$ 1,679   | Discounted cash flow  | Discount rate  | 5.1%                     |
|  |            |   | Probabilities of achieving remaining milestones      | 80.0% - 100.0% (90.0%)   |
| Revenue Earnout                        | \$ 5,290   | Discounted cash flow  | Weighted average cost of capital                     | 16.7%                    |
|  |            |   | Probability weighting of achieving revenue forecasts | 10.0% - 35.0% (27.1%)    |

**6. Sale of Mainframe Technology**

On January 6, 2012, the Company sold certain assets including intellectual property and residual assets which comprised its semiconductor mainframe technology for \$3.0 million in cash to Brooks Automation Inc. ( Brooks ) and recorded a gain of \$2.2 million.

The following table summarizes the components of the gain (in thousands):

|                               |          |
|-------------------------------|----------|
| Cash proceeds                 | \$ 3,000 |
| Assets sold:                  |          |
| Inventories                   | 589      |
| Property, plant and equipment | 178      |
| Transaction and other costs   | 26       |
| Gain on sale                  | \$ 2,207 |

**7. 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.

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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.

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

The following table displays the activity in the warranty provision account for the three and six months ended June 30, 2012 and July 2, 2011:

|  | <b>Three Months Ended</b> |                | <b>Six Months Ended</b> |                |
|--|---------------------------|----------------|-------------------------|----------------|
|  | <b>June</b>               | <b>July 2,</b> | <b>June</b>             | <b>July 2,</b> |
|  | <b>30,</b>                | <b>2011</b>    | <b>30,</b>              | <b>2011</b>    |
|  | <b>2012</b>               |                |                         |                |
|  | <b>(In thousands)</b>     |                |                         |                |
| Opening balance  | \$ 2,494                  | \$ 3,092       | \$ 2,724                | \$ 3,415       |
| Expenditures incurred under warranties                             | (410)                     | (532)          | (1,190)                 | (1,349)        |
| Accruals for product warranties issued during the reporting period | 447                       | 619            | 874                     | 999            |
| Adjustments to previously existing warranty accruals               | 327                       | (52)           | 450                     | 62             |
| Closing balance  | \$ 2,858                  | \$ 3,127       | \$ 2,858                | \$ 3,127       |

The following table displays the balance sheet classification of the warranty provision account at June 30, 2012 and at December 31, 2011:

|                             | <b>June 30,</b>       | <b>December 31,</b> |
|-----------------------------|-----------------------|---------------------|
|                             | <b>2012</b>           | <b>2011</b>         |
|                             | <b>(In thousands)</b> |                     |
| Other accrued liabilities   | \$ 2,671              | \$ 2,586            |
| Other long-term liabilities | 187                   | 138                 |
| Total warranty provision    | \$ 2,858              | \$ 2,724            |

**8. 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 judgment 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.



**Table of Contents****INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****9. Cash, Cash Equivalents and Investments**

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

|  | Amortized<br>Cost | June 30, 2012<br>Unrealized<br>Holding<br>Gains |               | Unrealized<br>Holding<br>Losses | Fair Value        |
|--|-------------------|---|---------------|---------------------------------|-------------------|
|  |                   | (In thousands)                                  |               |                                 |                   |
| <b>Cash and cash equivalents:</b>                    |                   |   |               |                                 |                   |
| Cash   | \$ 6,783          | \$  | \$            |                                 | \$ 6,783          |
| Money market funds                                   | 3,415             |   |               |                                 | 3,415             |
| Commercial paper                                     | 2,400             |   |               |                                 | 2,400             |
| <b>Total cash and cash equivalents</b>               | <b>\$ 12,598</b>  | <b>\$</b>                                       | <b>\$</b>     |                                 | <b>\$ 12,598</b>  |
| <b>Short-term investments:</b>                       |                   |   |               |                                 |                   |
| Corporate bonds and medium-term notes                | \$ 35,953         | \$ 49   | \$ 10         |                                 | \$ 35,992         |
| FDIC insured corporate bonds                         | 3,625             | 7   |               |                                 | 3,632             |
| Municipal bonds                                      | 4,452             | 3   |               |                                 | 4,455             |
| U.S. treasury and agency securities                  | 8,995             | 24  |               |                                 | 9,019             |
| Variable rate demand notes ( VRDNs )                 | 445               |   |               |                                 | 445               |
| <b>Total short-term investments</b>                  | <b>\$ 53,470</b>  | <b>\$ 83</b>                                    | <b>\$ 10</b>  |                                 | <b>\$ 53,543</b>  |
| <b>Long-term investments:</b>                        |                   |   |               |                                 |                   |
| Corporate bonds and medium-term notes                | \$ 9,992          | \$  | \$ 22         |                                 | \$ 9,970          |
| Municipal bonds                                      | 2,207             |   | 3             |                                 | 2,204             |
| U.S. treasury and agency securities                  | 23,476            | 16  | 4             |                                 | 23,488            |
| Auction rate security ( ARS )                        | 1,900             |   | 239           |                                 | 1,661             |
| <b>Total long-term investments</b>                   | <b>\$ 37,575</b>  | <b>\$ 16</b>                                    | <b>\$ 268</b> |                                 | <b>\$ 37,323</b>  |
| <b>Total cash, cash equivalents, and investments</b> | <b>\$ 103,643</b> | <b>\$ 99</b>                                    | <b>\$ 278</b> |                                 | <b>\$ 103,464</b> |

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

|  | Amortized<br>Cost | December 31, 2011<br>Unrealized<br>Holding Gains      Unrealized<br>Holding Losses |               | Fair Value        |
|--|-------------------|--|---------------|-------------------|
|  |                   | (In thousands)   |               |                   |
| <b>Cash and cash equivalents:</b>                    |                   |  |               |                   |
| Cash   | \$ 14,268         | \$   | \$            | \$ 14,268         |
| Money market funds                                   | 4,845             |  |               | 4,845             |
| Commercial paper                                     | 4,447             |  |               | 4,447             |
| <b>Total cash and cash equivalents</b>               | <b>\$ 23,560</b>  | <b>\$</b>  | <b>\$</b>     | <b>\$ 23,560</b>  |
| <b>Short-term investments:</b>                       |                   |  |               |                   |
| Commercial paper                                     | \$ 1,050          | \$   | \$            | \$ 1,050          |
| Corporate bonds and medium-term notes                | 26,665            | 28   | 78            | 26,615            |
| FDIC insured corporate bonds                         | 9,596             | 23   |               | 9,619             |
| Municipal bonds                                      | 4,898             | 10   |               | 4,908             |
| U.S. treasury and agency securities                  | 13,987            | 56   |               | 14,043            |
| VRDNs  | 2,350             |  |               | 2,350             |
| <b>Total short-term investments</b>                  | <b>\$ 58,546</b>  | <b>\$ 117</b>  | <b>\$ 78</b>  | <b>\$ 58,585</b>  |
| <b>Long-term investments:</b>                        |                   |  |               |                   |
| Corporate bonds and medium-term notes                | \$ 14,761         | 16   | 77            | \$ 14,700         |
| U.S. treasury and agency securities                  | 13,466            | 22   | 1             | 13,487            |
| ARS  | 4,900             |  | 410           | 4,490             |
| <b>Total long-term investments</b>                   | <b>\$ 33,127</b>  | <b>\$ 38</b>   | <b>\$ 488</b> | <b>\$ 32,677</b>  |
| <b>Total cash, cash equivalents, and investments</b> | <b>\$ 115,233</b> | <b>\$ 155</b>  | <b>\$ 566</b> | <b>\$ 114,822</b> |

The contractual maturities of available-for-sale securities at June 30, 2012 are presented in the following table.

|                                 | Amortized<br>Cost | Fair Value       |
|---------------------------------|-------------------|------------------|
|                                 | (In thousands)    |                  |
| Due in one year or less         | \$ 58,290         | \$ 58,363        |
| Due after one through two years | 35,675            | 35,662           |
| Due after ten years (1)         | 2,895             | 2,656            |
|                                 | <b>\$ 96,860</b>  | <b>\$ 96,681</b> |

(1) Includes \$445,000 in par value of VRDNs and \$1.9 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 June 30, 2012.

|                                       | <b>June 30, 2012</b>                                |  |  |  |
|---------------------------------------|---|--|--|--|
|                                       | <b>In Loss Position for<br/>Less than 12 Months</b> |  | <b>In Loss Position for<br/>Greater than 12 Months</b> |  |
|                                       | <b>Fair<br/>Value</b>                               | <b>Gross<br/>Unrealized<br/>Losses</b> | <b>Fair<br/>Value</b>                                  | <b>Gross<br/>Unrealized<br/>Losses</b> |
|                                       | <b>(In thousands)</b>                               |  |  |  |
| Corporate bonds and medium-term notes | \$ 24,504   | \$ 32                                  | \$   | \$                                     |
| Municipal bonds                       | 2,204   | 3                                      |  |  |
| U.S. treasury and agency securities   | 8,190   | 4                                      |  |  |
| ARS                                   |   |  | 1,661  | 239                                    |
|                                       | <b>\$ 34,898</b>                                    | <b>\$ 39</b>                           | <b>\$ 1,661</b>  | <b>\$ 239</b>                          |

All prices for the fixed maturity securities including U.S. Treasury and agency securities, commercial paper, FDIC insured corporate bonds, 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 the above-mentioned securities and has not made, during the periods presented, any material adjustments to such inputs.

As of June 30, 2012, the Company's Level 3 financial instrument consisted of an ARS with a par value of \$1.9 million that failed at auction. There was insufficient observable market information to determine fair value for this financial instrument. The Company estimated the fair value for this security by incorporating assumptions that it believes 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. The Company determined its ARS to have a temporary impairment of \$239,000 as of June 30, 2012. The estimated fair value could change significantly based on future market conditions. The Company will continue to assess the fair value of its ARS for substantive changes in relevant market conditions, changes in its financial condition or other changes that may alter its estimates described above. The failed ARS represents approximately 1.6% of the Company's total cash, cash equivalents and investments as of June 30, 2012. In May 2012, the Company participated in a tender offer, sold an ARS with a par value of \$3.0 million, collected \$2.8 million and recognized a realized loss on the sale of \$229,000. In June 2011, the Company participated in a tender offer, sold an ARS with a par value of \$3.0 million, collected \$2.9 million and recognized a realized loss on the sale of \$150,000.

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

The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the ARS as of June 30, 2012. Significant increases or decreases in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement.

|     | Fair Value | Quantitative Information about Level 3 Fair Value Measurements at June 30, 2012 |  |                          |
|-----|------------|---|--|--------------------------|
|     |            | Valuation Technique   | Unobservable Input<br>(In thousands, except for percentages) | Range (Weighted Average) |
| ARS | \$ 1,661   | Discounted cash flow  | Probability of default                                       | 12.87% - 15.01% (13.94%) |
|     |            |   | Probability of earning maximum rate to maturity              | 0.10% - 0.16% (0.13%)    |
|     |            |   | Probability of principal returned prior to maturity          | 84.83% - 87.03% (85.93%) |
|     |            |   | Liquidity risk premium                                       | 4.00% - 5.00% (4.50%)    |
|     |            |   | Recovery rate in default                                     | 40.00% - 60.00% (50.00%) |

The following table represents the fair value hierarchy of Intevac's available-for-sale securities measured at fair value on a recurring basis as of June 30, 2012.

|   | Fair Value Measurements at June 30, 2012 |           |           |          |
|---|--|-----------|-----------|----------|
|   | Total                                    | Level 1   | Level 2   | Level 3  |
|   | (In thousands)                           |           |           |          |
| Recurring fair value measurements:      |  |           |           |          |
| Available-for-sale securities           |  |           |           |          |
| Money market funds                      | \$ 3,415                                 | \$ 3,415  | \$        | \$       |
| U.S. treasury and agency securities     | 32,507                                   | 12,704    | 19,803    |          |
| Commercial paper                        | 2,400                                    |           | 2,400     |          |
| Corporate bonds and medium-term notes   | 45,962                                   |           | 45,962    |          |
| FDIC insured corporate bonds            | 3,632                                    |           | 3,632     |          |
| Municipal bonds                         | 6,659                                    |           | 6,659     |          |
| VRDNs                                   | 445                                      |           | 445       |          |
| ARS                                     | 1,661                                    |           |           | 1,661    |
| Total recurring fair value measurements | \$ 96,681                                | \$ 16,119 | \$ 78,901 | \$ 1,661 |

The following table presents the changes in Level 3 instruments measured on a recurring basis for the three and six months ended June 30, 2012 and July 2, 2011. These balances consist of ARS classified as available-for-sale with changes in fair value recorded in stockholders' equity.

|                 | Three Months Ended |              | Six Months Ended |              |
|-----------------|--------------------|--------------|------------------|--------------|
|                 | June 30, 2012      | July 2, 2011 | June 30, 2012    | July 2, 2011 |
|                 | (In thousands)     |              |                  |              |
| Opening balance | \$ 4,490           | \$ 10,281    | \$ 4,490         | \$ 10,273    |



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|  |          |          |          |          |
|--|----------|----------|----------|----------|
| Total gains (losses) for the period    |          |          |          |          |
| Included in earnings                   | (229)    | (150)    | (229)    | (150)    |
| Included in other comprehensive income | 171      | 146      | 171      | 154      |
| Proceeds from tender offers            | (2,771)  | (2,850)  | (2,771)  | (2,850)  |
| Redemptions at par                     |          | (300)    |          | (300)    |
| Closing balance                        | \$ 1,661 | \$ 7,127 | \$ 1,661 | \$ 7,127 |

**Table of Contents****INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****10. Accumulated Other Comprehensive Income**

The components of accumulated other comprehensive income at June 30, 2012 and December 31, 2011 were as follows:

|   | June 30,<br>2012 | December 31,<br>2011 |
|---|------------------|----------------------|
|   | (In thousands)   |                      |
| Accumulated net unrealized holding loss on available-for-sale investments, net of tax | \$ (116)         | \$ (267)             |
| Foreign currency translation gains  | 667              | 681                  |
| <b>Total accumulated other comprehensive income</b>                                   | <b>\$ 551</b>    | <b>\$ 414</b>        |

**11. Net Loss Per Share**

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

|   | Three Months Ended                       |                 | Six Months Ended |                 |
|---|--|-----------------|------------------|-----------------|
|   | June 30,<br>2012                         | July 2,<br>2011 | June 30,<br>2012 | July 2,<br>2011 |
|   | (in thousands, except per share amounts) |                 |                  |                 |
| Net loss  | \$ (1,493)                               | \$ (2,619)      | \$ (4,654)       | \$ (9,650)      |
| Weighted-average shares basic                         | 23,265                                   | 22,851          | 23,241           | 22,789          |
| Effect of dilutive potential common shares            |  |                 |                  |                 |
| Weighted-average shares diluted                       | 23,265                                   | 22,851          | 23,241           | 22,789          |
| Net loss per share basic and diluted                  | \$ (0.06)                                | \$ (0.11)       | \$ (0.20)        | \$ (0.42)       |
| Antidilutive shares based on employee awards excluded | 2,871                                    | 2,864           | 2,910            | 2,329           |

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

**12. 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 June 30, 2012 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed.

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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

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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, gains and losses on divestitures and sales of intellectual property, and unallocated costs in measuring the performance of the reportable segments.

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

The Intevac Photonics segment develops and manufactures leading-edge, high-sensitivity imaging products and vision systems as well as materials identification instruments utilizing Raman technology. 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, scientific and medical industries.

Information for each reportable segment for the three and six months ended June 30, 2012 and July 2, 2011 is as follows:

**Net Revenues**

|                                   | Three Months Ended |                  | Six Months Ended |                  |
|-----------------------------------|--------------------|------------------|------------------|------------------|
|                                   | June 30,<br>2012   | July 2,<br>2011  | June 30,<br>2012 | July 2,<br>2011  |
|                                   | (In thousands)     |                  |                  |                  |
| Equipment                         | \$ 25,059          | \$ 19,815        | \$ 35,778        | \$ 29,995        |
| Intevac Photonics                 | 6,732              | 7,770            | 13,329           | 15,013           |
| <b>Total segment net revenues</b> | <b>\$ 31,791</b>   | <b>\$ 27,585</b> | <b>\$ 49,107</b> | <b>\$ 45,008</b> |

**Operating Income (Loss)**

|  | Three Months Ended  |                 | Six Months Ended |                 |
|--|---------------------|-----------------|------------------|-----------------|
|  | June<br>30,<br>2012 | July 2,<br>2011 | June 30,<br>2012 | July 2,<br>2011 |
|  | (In thousands)      |                 |                  |                 |
| Equipment  | \$ 1,129            | \$ (2,794)      | \$ (5,196)       | \$ (9,064)      |
| Intevac Photonics                                  | (616)               | (493)           | (1,656)          | (2,076)         |
| <b>Total income (loss) from segment operations</b> | <b>513</b>          | <b>(3,287)</b>  | <b>(6,852)</b>   | <b>(11,140)</b> |
| Unallocated costs                                  | (1,191)             | (1,374)         | (2,988)          | (3,038)         |
| Gain on sale of mainframe technology               |                     |                 | 2,207            |                 |

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|                                |          |            |            |             |
|--------------------------------|----------|------------|------------|-------------|
| Loss from operations           | (678)    | (4,661)    | (7,633)    | (14,178)    |
| Interest income and other, net | 48       | 169        | 420        | 298         |
| Loss before income taxes       | \$ (630) | \$ (4,492) | \$ (7,213) | \$ (13,880) |

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Total assets for each reportable segment as of June 30, 2012 and December 31, 2011 are as follows:

**Assets**

|  | <b>June 30,<br/>2012</b> | <b>December 31,<br/>2011</b> |
|--|--------------------------|------------------------------|
|  | <b>(In thousands)</b>    |                              |
| Equipment                              | \$ 58,320                | \$ 48,133                    |
| Intevac Photonics                      | 28,709                   | 29,947                       |
| <b>Total segment assets</b>            | <b>87,029</b>            | <b>78,080</b>                |
| Cash, cash equivalents and investments | 103,464                  | 114,822                      |
| Deferred income taxes                  | 26,669                   | 23,919                       |
| Other current assets                   | 6,534                    | 6,848                        |
| Common property, plant and equipment   | 1,252                    | 1,366                        |
| Other assets                           | 778                      | 786                          |
| <b>Consolidated total assets</b>       | <b>\$ 225,726</b>        | <b>\$ 225,821</b>            |

**13. Income Taxes**

Intevac recorded an income tax provision of \$863,000 and an income tax benefit of \$2.6 million for the three and six months ended June 30, 2012, respectively. Intevac recorded income tax benefits of \$1.9 million and \$4.2 million for the three and six months ended July 2, 2011, respectively. The income tax provision for each three and six month period is based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates, except that certain discrete items are treated separately.

For the three months ended June 30, 2012, Intevac recorded a tax provision on a pre-tax loss for the quarter, primarily due to a change in the estimate of the Company's fiscal 2012 loss and its geographic composition, which resulted in an adjustment to the benefit recorded on the year-to-date pre-tax loss. The income tax benefit for the six months ended June 30, 2012 was reduced by a net \$244,000 discrete income tax charge related to the gain on the sale of the mainframe technology, which was partially offset by the release of a valuation allowance related to certain deferred tax assets and tax refunds received from Singapore and California.

The effective tax rates for all periods presented differ from the U.S. federal statutory tax rate of 35% primarily due to foreign income taxed in lower rate jurisdictions. Intevac's future effective income tax rate depends on various factors including, the level of Intevac's projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carry-forwards, availability of tax credits and the effectiveness of Intevac's tax planning strategies. Management carefully monitors these factors and timely adjusts the effective income tax rate accordingly.

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.

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

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**INTEVAC, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

tax credit carry forwards remaining or utilized in an otherwise open year. During the quarter ended June 30, 2012, the Internal Revenue Service concluded its review of the Company's fiscal year 2009 tax return which arose from an income tax refund generated by a carry-back claim and the examination is pending approval from the U.S. Joint Committee on Taxation. Additionally, the Singapore Inland Revenue Authority is conducting an examination of the fiscal 2009 tax return of the Company's wholly-owned subsidiary, Intevac Asia Pte. Ltd. Presently, there are no other active income tax examinations in the jurisdictions where Intevac operates.

**14. 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.



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**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 2012 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 21, 2012, 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 and high-productivity process manufacturing equipment and inspection solutions to the PV 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 include manufacturers of hard disk drives and PV cells as well as the U.S. government and its agencies and contractors; and medical, scientific and security companies. Intevac reports two segments: Equipment and Intevac Photonics. During the first quarter of 2012, Intevac sold certain assets comprising its semiconductor mainframe technology to Brooks.

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 by worldwide demand for hard disk drives, which in turn depends on end-user demand for personal computers, enterprise data storage, including on-line, cloud storage and near-line applications, personal audio and video players and video game platforms that include such drives. Demand for Intevac's equipment is impacted by Intevac's customers' relative market share positions and production capacity needs. Intevac continues to execute its strategy of equipment diversification into new markets by introducing products for PV solar cell manufacturing. Intevac believes that expansion into this market, which is 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 and PV cells, as well as other factors such as global economic conditions and technological advances in fabrication processes.

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The following table presents certain significant measurements for the three and six months ended June 30, 2012 and July 2, 2011:

|                        | Three months ended                                       |                 |                             | Six months ended |                 |                             |
|------------------------|--|-----------------|-----------------------------|------------------|-----------------|-----------------------------|
|                        | June 30,<br>2012   | July 2,<br>2011 | Change over<br>prior period | June 30,<br>2012 | July 2,<br>2011 | Change over<br>prior period |
|                        | (In thousands, except percentages and per share amounts) |                 |                             |                  |                 |                             |
| Net revenues           | \$ 31,791  | \$ 27,585       | \$ 4,206                    | \$ 49,107        | \$ 45,008       | \$ 4,099                    |
| Gross profit           | \$ 14,254  | \$ 10,137       | \$ 4,117                    | \$ 21,078        | \$ 16,518       | \$ 4,560                    |
| Gross margin percent   | 44.8%  | 36.7%           | 8.1 points                  | 42.9%            | 36.7%           | 6.2 points                  |
| Net loss               | \$ (1,493)   | \$ (2,619)      | \$ 1,126                    | \$ (4,654)       | \$ (9,650)      | \$ 4,996                    |
| Loss per diluted share | \$ (0.06)  | \$ (0.11)       | \$ 0.05                     | \$ (0.20)        | \$ (0.42)       | \$ 0.22                     |

Financial results for the second quarter and first six months for fiscal 2012 improved over the same periods in the prior year. Net revenues increased during the second quarter and first six months of fiscal 2012 primarily due to higher upgrade sales to disk manufacturers and higher Intevac Photonics technology development contracts, offset in part by lower Photonics product sales. The net loss for the second quarter of fiscal 2012 decreased compared to the same period in the prior year due to higher revenues and improved gross margins offset in part by increased operating expenses and recognition of an income tax provision. The net loss for the first six months of fiscal 2012 decreased compared to the same period in the prior year due to higher revenues, improved gross margins and the gain recognized on the sale of the mainframe technology to Brooks offset in part by increased operating expenses and recognition of a smaller income tax benefit.

At the beginning of fiscal 2012 Intevac believed that as the consolidations in the hard drive industry were completed and as the hard drive industry recovered from the compounding disruptive effects of the Thailand flooding, which occurred the fourth quarter of fiscal 2011, Intevac's hard drive customers would resume purchasing Intevac equipment to support their fourth quarter production demands. Although the hard drive industry has recovered from the floods faster than originally anticipated, new worries about a global economic slowdown and lower than forecasted growth in personal computer sales have dampened the expected growth in demand for hard drives in the back end of the year. Intevac's hard drive customers are expected to add fewer systems in fiscal 2012 than originally anticipated. Intevac continues to believe that long-term demand for hard disk drives will increase, driven by growth in demand for digital storage, the need for corporations to replace and update employee computers, increased information technology spending, declining growth rate in areal density improvements and the proliferation of personal computers into emerging economies. The number of disk manufacturing systems needed to support this growth is expected to vary from year to year depending on the factors noted above. In fiscal 2012, Intevac expects to complete additional customer qualifications on its PV manufacturing products and start to obtain repeat orders from customers.

In fiscal 2012, Intevac expects that Intevac Photonics business levels will grow driven primarily by the recovery of the contract research and development ( R&D ) business, as several key U.S. defense programs received budgetary funding in the fourth quarter of 2011 and the U.S. military continues to develop night vision solutions based on Intevac's digital low-light sensor technology. Substantial growth in future Intevac Photonics revenues is dependent on the 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 Intevac's development and market acceptance of commercial products.

Intevac's trademarks include the following: 200 Lean AccuLuber , DeltaNEAPS ENERGi , ExaminerR , I-Port , LEAN SOLAR , LithoPrime , LPVARMicroVista NanoVista , LEAN SOLAR NanoTexture , NightVista , PHARMA-ID , and .RAPID-ID

**Table of Contents****Results of Operations***Net revenues*

|                           | Three months ended |                  |                                | Six months ended |                  |                                |
|---------------------------|--------------------|------------------|--------------------------------|------------------|------------------|--------------------------------|
|                           | June 30,<br>2012   | July 2,<br>2011  | Change over<br>prior<br>period | June 30,<br>2012 | July 2,<br>2011  | Change over<br>prior<br>period |
|                           | (In thousands)     |                  |                                |                  |                  |                                |
| Equipment                 | \$ 25,059          | \$ 19,815        | \$ 5,244                       | \$ 35,778        | \$ 29,995        | \$ 5,783                       |
| Intevac Photonics         | 6,732              | 7,770            | (1,038)                        | 13,329           | 15,013           | (1,684)                        |
| <b>Total net revenues</b> | <b>\$ 31,791</b>   | <b>\$ 27,585</b> | <b>\$ 4,206</b>                | <b>\$ 49,107</b> | <b>\$ 45,008</b> | <b>\$ 4,099</b>                |

Equipment revenue for the three and six months ended June 30, 2012 increased over the same periods in the prior year as a result of higher sales of technology upgrades and spare parts, offset in part by fewer sales of disk sputtering systems. During the second quarter of 2012 Intevac recognized revenue on two 200 Lean<sup>®</sup> systems, two AccuLuber<sup>™</sup> systems, one LEAN SOLAR NanoTexture etch system, disk equipment technology upgrades, and spare parts. During the second quarter of 2011 Intevac recognized revenue on three 200 Lean systems, one AccuLuber system, three wafer handling systems, disk equipment technology upgrades, and spare parts. Equipment revenue for the six months ended June 30, 2012 included revenue recognition for two 200 Lean systems, six AccuLuber systems, one PV etch system, upgrades and spare parts. Equipment revenue for the six months ended July 2, 2011 included revenue recognition for three 200 Lean systems, four AccuLuber systems, three wafer handling systems, upgrades and spare parts.

Intevac Photonics revenue for the three and six months ended June 30, 2012 decreased over the same periods in the prior year which was the result of decreased product sales, offset in part by increased contract R&D work. Intevac Photonics revenues for the three months ended June 30, 2012 consisted of \$3.2 million of contract R&D revenue and \$3.6 million of product sales as compared to \$1.9 million of contract R&D revenue and \$5.9 million of product sales for the three months ended July 2, 2011. Intevac Photonics revenues for the six months ended June 30, 2012 consisted of \$5.7 million of contract R&D revenue and \$7.6 million of product sales as compared to \$3.8 million of contract R&D and \$11.2 million of product sales for the six months ended July 2, 2011. The decrease in product revenue resulted from lower sales of low-light sensors and cameras used in military night vision and long-range imaging as well as commercial applications such as Intevac's near-eye display and Raman spectroscopy products. Product revenue declined due to reduced delivery quantity requirements of Intevac Photonics customers in the near term. Intevac expects that volumes will resume to previous levels in late 2012 and early 2013. The increase in contract R&D revenue was the result of a higher volume of contracts due to the resumption of U.S. government defense spending and due to the continued expansion of Intevac's low-light camera and sensor products in military and commercial applications.

Intevac's backlog of orders at June 30, 2012 was \$43.3 million, compared to \$32.9 million at December 31, 2011 and \$36.9 million at July 2, 2011. The \$43.3 million of backlog at June 30, 2012 consisted of \$14.6 million of Equipment backlog and \$28.7 million of Intevac Photonics backlog. The \$32.9 million of backlog at December 31, 2011 consisted of \$17.9 million of Equipment backlog and \$15.0 million of Intevac Photonics backlog. Backlog at June 30, 2012 does not include any LEAN SOLAR or 200 Lean systems as compared to one LEAN SOLAR system at December 31, 2011 and two LEAN SOLAR systems at July 2, 2011.

International sales increased by 19.4% to \$25.0 million for the three months ended June 30, 2012 from \$20.9 million for the three months ended July 2, 2011 and by 16.8% to \$36.4 million for the six months ended June 30, 2012 from \$31.2 million for the six months ended July 2, 2011. International sales include products shipped to overseas operations of U.S. companies. The increase in international sales was primarily due to an increase in net revenues from technology upgrades and spare parts. Substantially all of Intevac's international sales are to customers in Asia. International sales constituted 78.6% of net revenues for the three months ended June 30, 2012 and 75.9% of net revenues for the three months ended July 2, 2011. International sales constituted 74.2% of net revenues for the six months ended June 30, 2012 and 69.3% of net revenues for the six months ended July 2, 2011. 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.

**Table of Contents***Gross profit*

|                                     | Three months ended                 |                 |                                | Six months ended |                 |                                |
|-------------------------------------|------------------------------------|-----------------|--------------------------------|------------------|-----------------|--------------------------------|
|                                     | June 30,<br>2012                   | July 2,<br>2011 | Change over<br>prior<br>period | June 30,<br>2012 | July 2,<br>2011 | Change over<br>prior<br>period |
|                                     | (In thousands, except percentages) |                 |                                |                  |                 |                                |
| Equipment gross profit              | \$ 11,810                          | \$ 7,598        | \$ 4,212                       | \$ 16,646        | \$ 12,208       | \$ 4,438                       |
| % of Equipment net revenues         | 47.1%                              | 38.3%           |                                | 46.5%            | 40.7%           |                                |
| Intevac Photonics gross profit      | \$ 2,444                           | \$ 2,539        | \$ (95)                        | \$ 4,432         | \$ 4,310        | \$ 122                         |
| % of Intevac Photonics net revenues | 36.3%                              | 32.7%           |                                | 33.2%            | 28.7%           |                                |
| Total gross profit                  | \$ 14,254                          | \$ 10,137       | \$ 4,117                       | \$ 21,078        | \$ 16,518       | \$ 4,560                       |
| % of net revenues                   | 44.8%                              | 36.7%           |                                | 42.9%            | 36.7%           |                                |

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 47.1% in the three months ended June 30, 2012 compared to 38.3% in the three months ended July 2, 2011 and was 46.5% in the six months ended June 30, 2012 compared to 40.7% in the six months ended July 2, 2011. The higher gross margin was due primarily to higher system margins, and a higher mix of upgrade and spares shipments, offset in part by lower factory utilization and higher provisions for inventory obsolescence. Gross margins in the Equipment business will vary depending on a number of factors, including product mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

Intevac Photonics gross margin was 36.3% in the three months ended June 30, 2012 compared to 32.7% in the three months ended July 2, 2011 and was 33.2% in the six months ended June 30, 2012 compared to 28.7% in the six months ended July 2, 2011. Although revenue declined during the three and six months ended June 30, 2012 compared to the same periods in the prior year gross margin percentages improved compared to the prior year periods due to a favorable mix of product sales and reductions in cost. The improvement in gross margin percentage in the three and six months ended June 30, 2012 compared to the same periods in the prior year resulted primarily from improved margins on product sales due to cost reductions associated with digital night-vision products offset in part by lower margins on contract R & D. Gross margins during the six months ended July 2, 2011 reflected a charge recognized for inventory write-offs that did not reoccur during fiscal 2012. Gross margins in the Intevac Photonics business will vary depending on a number of factors, including product mix, product cost, pricing, factory utilization, and provisions for excess and obsolete inventory.

*Research and development*

|                                  | Three months ended |                 |                                | Six months ended |                 |                                |
|----------------------------------|--------------------|-----------------|--------------------------------|------------------|-----------------|--------------------------------|
|                                  | July 30,<br>2012   | July 2,<br>2011 | Change over<br>prior<br>period | July 30,<br>2012 | July 2,<br>2011 | Change over<br>prior<br>period |
|                                  | (In thousands)     |                 |                                |                  |                 |                                |
| Research and development expense | \$ 8,263           | \$ 8,290        | \$ (27)                        | \$ 17,476        | \$ 17,302       | \$ 174                         |

Equipment research and development spending decreased slightly during the three months ended June 30, 2012 as compared to the same period in the prior year due primarily to lower spending on prototype materials for PV development. Equipment research and development spending increased during the six months ended June 30, 2012

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as compared to the same period in the prior year due primarily to increased PV development. Intevac Photonics research and development spending increased slightly during the three months ended June 30, 2012 as compared to the same period in the prior year due primarily to increased spending for digital night-vision product development but decreased during the six months ended June 30, 2012 as compared to the same period in the prior year reflecting cost containment efforts taken earlier in 2012, and a higher volume of billable contract R&D efforts. Research and development expenses do not include costs of \$2.3 million and \$3.9 million for the three and six months ended June 30, 2012 respectively, or \$1.0 million and \$2.4 million for the three and six months ended July 2, 2011, respectively, which are related to customer-funded contract R&D programs at Intevac Photonics and therefore included in cost of net revenues.

*Selling, general and administrative*

|   | Three months ended |                 |                                | Six months ended |                 |                                |
|---|--------------------|-----------------|--------------------------------|------------------|-----------------|--------------------------------|
|   | June 30,<br>2012   | July 2,<br>2011 | Change over<br>prior<br>period | June 30,<br>2012 | July 2,<br>2011 | Change over<br>prior<br>period |
|   | (In thousands)     |                 |                                |                  |                 |                                |
| Selling, general and administrative expense | \$ 6,669           | \$ 6,508        | \$ 161                         | \$ 13,442        | \$ 13,394       | \$ 48                          |

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 and six months ended June 30, 2012 compared to the three and six months ended July 2, 2011 was primarily the result of higher Equipment marketing spending associated with new products in the PV market.

*Gain on sale of mainframe technology*

On January 6, 2012, the Company sold certain assets including intellectual property and residual assets which comprised its semiconductor mainframe technology for \$3.0 million in cash to Brooks and recorded a gain of \$2.2 million. See Note 6 *Sale of Mainframe Technology* in the notes to the condensed consolidated financial statements for additional information related to the gain on sale of the mainframe technology.

*Interest income and other, net*

|                                | Three months ended |                 |                                | Six months ended |                 |                                |
|--------------------------------|--------------------|-----------------|--------------------------------|------------------|-----------------|--------------------------------|
|                                | June 30,<br>2012   | July 2,<br>2011 | Change over<br>prior<br>period | June 30,<br>2012 | July 2,<br>2011 | Change over<br>prior<br>period |
|                                | (In thousands)     |                 |                                |                  |                 |                                |
| Interest income and other, net | \$ 48              | \$ 169          | \$ (121)                       | \$ 420           | \$ 298          | \$ 122                         |

Interest income and other, net is comprised of interest income and realized gains and losses on sales of investments, foreign currency gains and losses, and other income and expense such as gains and losses on sales of fixed assets.

**Table of Contents***Income tax provision (benefit)*

|                                | Three months ended |                 |                                | Six months ended |                 |                                |
|--------------------------------|--------------------|-----------------|--------------------------------|------------------|-----------------|--------------------------------|
|                                | June 30,<br>2012   | July 2,<br>2011 | Change over<br>prior<br>period | June 30,<br>2012 | July 2,<br>2011 | Change over<br>prior<br>period |
|                                | (In thousands)     |                 |                                |                  |                 |                                |
| Income tax provision (benefit) | \$ 863             | \$ (1,873)      | \$ 2,736                       | \$ (2,559)       | \$ (4,230)      | \$ 1,671                       |

Intevac recorded an income tax provision of \$863,000 and an income tax benefit of \$2.6 million for the three and six months ended June 30, 2012, respectively. Intevac recorded income tax benefits of \$1.9 million and \$4.2 million for the three and six months ended July 2, 2011, respectively. The income tax provision for each three and six month period is based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates, except that certain discrete items are treated separately.

For the three months ended June 30, 2012, Intevac recorded a tax provision on a pre-tax loss for the quarter, primarily due to a change in the estimate of the Company's fiscal 2012 loss and its geographic composition, which resulted in an adjustment to the benefit recorded on the year-to-date pre-tax loss. The income tax benefit for the six months ended June 30, 2012 was reduced by a net \$244,000 discrete income tax charge related to the gain on the sale of the mainframe technology, which was partially offset by the release of a valuation allowance related to certain deferred tax assets and tax refunds received from Singapore and California.

The effective tax rates for all periods presented differ from the U.S. federal statutory tax rate of 35% primarily due to foreign income taxed in lower rate jurisdictions. Intevac's future effective income tax rate depends on various factors including, the level of Intevac's projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carry-forwards, availability of tax credits and the effectiveness of Intevac's tax planning strategies. Management carefully monitors these factors and timely adjusts the effective income tax rate accordingly.

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 June 30, 2012, Intevac had \$103.5 million in cash, cash equivalents, and investments compared to \$114.8 million at December 31, 2011. During the first six months of 2012 cash, cash equivalents and investments decreased by \$11.4 million due primarily to cash used by operating activities, payment of acquisition-related contingent consideration and purchases of fixed assets partially offset by cash received from the sale of the mainframe technology and the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

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Cash, cash equivalents and investments consist of the following:

|  | June 30,<br>2012 | December 31,<br>2011 |
|--|------------------|----------------------|
|  | (In thousands)   |                      |
| Cash and cash equivalents                        | \$ 12,598        | \$ 23,560            |
| Short-term investments                           | 53,543           | 58,585               |
| Long-term investments                            | 37,323           | 32,677               |
| <br>Total cash, cash equivalents and investments | <br>\$ 103,464   | <br>\$ 114,822       |

Operating activities used cash of \$10.4 million during the first six months of 2012 and of \$11.6 million during the first six months of 2011. The decrease in cash used in operating activities was due primarily to a lower net loss, offset in part by an increase in the Company's non-cash net working capital position during the first six months of 2012 compared to the same period in the prior year.

Accounts receivable totaled \$25.9 million at June 30, 2012, compared to \$18.6 million at December 31, 2011. The increase of \$7.4 million in the receivable balance was due primarily to invoicing of system and other shipments. Total net inventories increased to \$19.8 million at June 30, 2012, compared to \$18.1 million at December 31, 2011 as the Company invested in inventories for its next generation PV products including placing systems under evaluation agreements at customers. Accounts payable increased to \$5.8 million at June 30, 2012 compared to \$4.9 million at December 31, 2011 in line with business levels. Customer deposits decreased to \$1.9 million at June 30, 2012 compared to \$5.0 million at December 31, 2011 as the Company consumed system backlog.

Investing activities in the first six months of 2012 generated cash of \$993,000. Purchases of investments net of proceeds from sales of investments totaled \$340,000. On January 6, 2012, the Company sold certain assets which comprised its semiconductor mainframe technology for \$3.0 million in cash to Brooks. Capital expenditures for the six months ended June 30, 2012 were \$1.7 million.

Financing activities in the first six months of 2012 used cash of \$1.5 million. Intevac generated cash of \$882,000 from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans. 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. On April 12, 2012, Intevac made \$2.4 million in payments to the selling shareholders of SIT for achievement of the second milestone. On July 2, 2012, Intevac made \$956,000 in payments to the selling shareholders of SIT for achievement of the third milestone.

Intevac's investment portfolio consists principally of investment grade money market mutual funds, FDIC insured corporate bonds, U.S. Treasury and agency securities, commercial paper, municipal bonds, corporate bonds and 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 June 30, 2012, Intevac's Level 3 available-for-sale security was comprised of a \$1.9 million par value ARS, less a temporary valuation adjustment of \$239,000 to reflect its current lack of liquidity. Management believes that the impairment of the ARS investment is temporary. As described in note 9 of notes to condensed consolidated financial statements, the fair value of the ARS was estimated at \$1.7 million using a discounted cash flow model. The estimates of future cash flows are based on certain key assumptions, such as discount rates appropriate for the type of asset and risk, 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. In May 2012, Intevac participated in a tender offer, sold an ARS with a par value of \$3.0 million, collected \$2.8 million and recognized a realized loss on the sale of \$229,000.

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As of June 30, 2012, approximately \$6.0 million of cash and cash equivalents and \$15.2 million of investments were domiciled in foreign tax jurisdictions. Intevac expects a significant portion of these funds to remain off shore in the short term. If the Company chose to repatriate these funds to the United States, it would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

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 \$2.5 million in capital expenditures during the remainder of 2012.

### **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 21, 2012. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

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 2011 Form 10-K. Management believes that there has been no significant change during the six months ended June 30, 2012 to the items identified as critical accounting policies in Intevac s 2011 Form 10-K.



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*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. The Company has adopted an investment policy and established guidelines relating to credit quality, diversification and maturities of its investments in order to preserve principal and maintain liquidity. All investment securities in Intevac's portfolio have an investment grade credit rating. Investments typically consist of commercial paper, FDIC insured corporate bonds, 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 June 30, 2012.

|                               | 2012                               | 2013      | 2014      | 2015 | 2016 | Beyond   | Total     | Fair Value |
|-------------------------------|------------------------------------|-----------|-----------|------|------|----------|-----------|------------|
|                               | (In thousands, except percentages) |           |           |      |      |          |           |            |
| <b>Cash equivalents</b>       |                                    |           |           |      |      |          |           |            |
| Fixed rate amounts            | \$ 2,400                           |           |           |      |      |          | \$ 2,400  | \$ 2,400   |
| Weighted-average rate         | 0.46%                              |           |           |      |      |          |           |            |
| Variable rate amounts         | \$ 3,415                           |           |           |      |      |          | \$ 3,415  | \$ 3,415   |
| Weighted-average rate         | 0.13%                              |           |           |      |      |          |           |            |
| <b>Short-term investments</b> |                                    |           |           |      |      |          |           |            |
| Fixed rate amounts            | \$ 29,882                          | \$ 20,494 |           |      |      |          | \$ 50,376 | \$ 50,447  |
| Weighted-average rate         | 3.27%                              | 3.27%     |           |      |      |          |           |            |
| Variable rate amounts         | \$ 3,094                           |           |           |      |      |          | \$ 3,094  | \$ 3,096   |
| Weighted-average rate         | 0.86%                              |           |           |      |      |          |           |            |
| <b>Long-term investments</b>  |                                    |           |           |      |      |          |           |            |
| Fixed rate amounts            |                                    | \$ 16,951 | \$ 18,724 |      |      | \$ 1,900 | \$ 37,575 | \$ 37,323  |
| Weighted-average rate         |                                    | 0.54%     | 1.45%     |      |      | 0.90%    |           |            |
| Total investment portfolio    | \$ 38,791                          | \$ 37,445 | \$ 18,724 |      |      | \$ 1,900 | \$ 96,860 | \$ 96,681  |

At June 30, 2012, Intevac held a \$1.9 million par value ARS with an estimated fair value of \$1.7 million, and net of a \$239,000 unrealized loss which is deemed temporary. Intevac continues to monitor the market for ARS and consider its impact (if any) on the fair market value of its investment. 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 2012. 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 this investment 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 hedge certain of its 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 June 30, 2012, Intevac had no foreign currency forward exchange contracts.

**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 June 30, 2012, 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,

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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 June 30, 2012.

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.

## **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,

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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 and 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 increased in 2010 as customers increased their production capacity in response to increased demand for digital storage, but decreased in 2011, as the hard disk drive industry did not add the same level of capacity that it did 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. 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.

***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 typically 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.

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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. These storage technologies are being used increasingly in personal computers and other electronics devices instead of disk drives, and new classes of such products, including Internet appliances, tablet computing devices, netbooks or mobile phones with advanced capabilities, or smartphones, have never contained, nor are they likely in the future to 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. Intevac is attempting to enter the PV equipment market, and faces competition from large established competitors including Applied Materials, Veeco Instruments, Centrotherm Photovoltaics, Roth & Rau AG, 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 BAE Systems. In the markets for our commercial imaging products we compete with companies such as Andor, Dalsa, E2V, Hamamatsu 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. Some of our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do, especially in the PV equipment market. Our competitors may develop enhancements to, or future generations of, competitive products that offer superior price or performance features, and new competitors may 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.

***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, when combined with changes in the customers' specific capacity plans and market share shifts can lead to extreme variability in our 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 Samsung's hard disk drive business in 2011. Western Digital acquired Komag in 2007, Hoya's magnetic media operations in 2010 and Hitachi Global Storage Technology in 2012. 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.

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***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 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 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 we have not recognized material revenue from such 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, cyclicity 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.

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 and have caused us to be cautious about our future outlook. Our customers also continue to remain cautious about the economy. 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.

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*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 our Photonics products and services directly to the U.S. government, as well as to prime contractors for various U.S. government programs. The U.S. government is considering significant changes in the level of existing, follow-on or replacement programs. We cannot predict the impact of potential changes in priorities due to military transformations and/or the nature of future war-related activities. A shift of government priorities to programs in which we do not participate and/or reductions in funding for or the termination of programs in which we do participate, unless offset by other programs and opportunities, could have a material adverse effect on our financial position, results of operations, or cash flows.

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 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.

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***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 so long as certain thresholds of business investment and employment levels are met in Singapore. We may lose our eligibility for such benefits if, among other things, these requirements are not met or if Intevac incurs net losses in Singapore 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 significant tax benefits in 2008, 2009, 2011 and 2012 based on our belief that we could both carry back losses and tax credits to years Intevac paid income taxes and carry forward losses and tax credits to future years where we believe we may generate taxable income. Intevac will need to generate approximately \$62.0 million of taxable income in the United States in order to fully realize the Federal deferred tax assets and \$29.2 million of taxable income in Singapore in order to fully realize the foreign deferred tax assets, each as recorded as of June 30, 2012. 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, Taiwan, 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 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.

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### ***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 4 Goodwill and Purchased Intangible Assets in the notes to the condensed consolidated financial statements for additional information related to impairment of goodwill and intangible assets.

### ***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 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. 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.



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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., in 2010 we acquired the outstanding shares of Solar Implant Technologies, Inc., and in 2012 we completed the sale of certain semiconductor mainframe technology assets to Brooks. 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 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. In addition, we have made and will continue to consider making strategic divestitures. With any divestiture, there are risks that future operating results could be unfavorably impacted if targeted objectives, such as cost savings, are not achieved or if other business disruptions occur as a result of the divestiture or activities related to the divestiture.

### ***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, floods 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. All these unforeseen disruptions and instabilities 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

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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, 2011, 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.

**Item 2.**      *Unregistered Sales of Equity Securities and Use of Proceeds*  
None.

**Item 3.**      *Defaults upon Senior Securities*  
None.

**Item 4.**      *Mine Safety Disclosures*  
Not Applicable.

**Item 5.**      *Other Information*  
None.

**Table of Contents****Item 6. Exhibits**

The following exhibits are filed herewith:

| Exhibit |  |
|---------|--|
| Number  | Description  |
| 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.  |
| 101.INS | XBRL Instance Document *   |
| 101.SCH | XBRL Taxonomy Extension Schema *   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document *  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document *   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document *  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document *   |

\* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933 or Section 18 of the Securities Exchange Act of 1934 and otherwise are not subject to liability.

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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: August 1, 2012

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

Date: August 1, 2012

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