

INTEVAC INC  
Form 10-K  
February 21, 2012

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**

**Washington, D.C. 20549**

**Form 10-K**

(Mark One)

**ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the fiscal year ended December 31, 2011

or

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_  
Commission file number 0-26946

**INTEVAC, INC.**

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

**Delaware**

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

**94-3125814**

*(I.R.S. 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**

**Securities registered pursuant to Section 12(b) of the Act:**

| <b>Title of each class</b>       | <b>Name of each exchange on which registered</b>   |
|----------------------------------|----------------------------------------------------|
| Common Stock (\$0.001 par value) | The Nasdaq Stock Market LLC (NASDAQ Global Select) |

**Securities registered pursuant to Section 12(g) of the Act:**

None.

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Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.  Yes  No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.  Yes  No

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 a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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 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  Smaller reporting company   
(Do not check if a smaller reporting company)

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

As of July 2, 2011, the aggregate market value of voting and non-voting stock held by non-affiliates of the Registrant, was approximately \$131,340,038 (based on the closing price for shares of the Registrant's Common Stock as reported by the Nasdaq Stock Market for the last trading day prior to that date). Shares of Common Stock held by each executive officer, director, and holder of 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On February 21, 2012, 23,256,984 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE.**

Portions of the Registrant's Proxy Statement for the 2012 Annual Meeting of Stockholders are incorporated by reference into Part III. Such proxy statement will be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

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**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain information in this Annual Report on Form 10-K (report or Form 10-K) of Intevac, Inc. and its subsidiaries ( Intevac or the Company ), including Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 7, is forward-looking in nature. All statements in this report, including those made by the management of Intevac, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding Intevac's future financial results, operating results, cash flows and cash deployment strategies, business strategies, costs, products, working capital, competitive positions, management's plans and objectives for future operations, research and development, acquisitions and joint ventures, growth opportunities, customer contracts, investments, liquidity, declaration of dividends, and legal proceedings, as well as market conditions and industry trends. These forward-looking statements are based on management's estimates, projections and assumptions as of the date hereof and include the assumptions that underlie such statements. Forward-looking statements may contain words such as may, will, should, could, would, expect, plan, anticipate, believe, predict, potential and continue, the negative of these terms, or other comparable terminology. Any expectations based on these forward-looking statements are subject to risks and uncertainties and other important factors, including those discussed in Item 1A, Risk Factors, below and elsewhere in this report. Other risks and uncertainties may be disclosed in Intevac's prior Securities and Exchange Commission ( SEC ) filings. These and many other factors could affect Intevac's future financial condition and operating results and could cause actual results to differ materially from expectations based on forward-looking statements made in this report or elsewhere by Intevac or on its behalf. Intevac undertakes no obligation to revise or update any forward-looking statements.

The following information should be read in conjunction with the Consolidated Financial Statements and the accompanying Notes to Consolidated Financial Statements included in this report.

**PART I**

**Item 1. Business**

**Overview**

Intevac's business consists of two reportable segments:

*Equipment:* Intevac is a leader in the design, development and marketing of high-productivity process manufacturing equipment solutions to the hard disk drive industry. Intevac also offers high-productivity process manufacturing equipment and inspection solutions for the solar photovoltaic ( PV ) industry.

*Intevac Photonics:* Intevac is a leader in the development and manufacture of leading edge, high-sensitivity imaging products and vision systems, as well as table-top and handheld Raman instruments. Markets addressed include military, industrial, medical and scientific.

Intevac was incorporated in October 1990 in California and completed a leveraged buyout of a number of divisions of Varian Associates in February 1991. Intevac was reincorporated in Delaware in 2007.

**Equipment Segment**

***Hard Disk Drive Equipment Market***

Intevac designs, manufactures, markets and services complex capital equipment used to deposit thin films onto substrates to produce magnetic disks that are used in hard disk drives, and also equipment to lubricate these disks. Disk and disk drive manufacturers produce magnetic disks in a sophisticated manufacturing process involving many steps, including plating, annealing, polishing, texturing, sputtering, etching, stripping and lubrication. Intevac believes its systems represent approximately 60% of the installed capacity of disk sputtering systems worldwide. Intevac's systems are used by manufacturers of magnetic media such as Seagate Technology, Hitachi Global Storage Technologies, Fuji Electric, Showa Denko and Western Digital.

Hard disk drives are a primary storage medium for digital data and are used in products and applications such as personal computers, enterprise data storage including on-line, cloud storage and near-line application, personal digital video players and video game platforms. Intevac believes that hard disk drive media shipments will continue to grow over time, driven by growth in digital storage, by the proliferation of personal computers into emerging economies, by new and emerging applications, and by the slowing of areal density improvements. Continued growth in hard disk drive shipments is a key factor in determining the demand for magnetic disks used in hard disk drives.

Demand for Intevac's disk manufacturing products is driven by a number of factors, including unit demand for hard disk drives, market share, the average number of magnetic disks used in each hard drive, areal density improvements, utilization and productivity of disk manufacturers installed base of magnetic disk manufacturing equipment and obsolescence of the installed base as a result of new technologies.

Intevac expects that hard disk drive manufacturers will extend their utilization of planar perpendicular media for the next several years with the introduction of thermal assisted magnetic recording ( TAMR ) followed by the introduction of patterned media, the next major media technology for the hard drive industry. Intevac believes that the transition to TAMR will require disk manufacturers to upgrade their installed base of equipment, which would result in increased demand for equipment technology upgrades to be performed by Intevac. The transition to patterned media by disk manufacturers, which introduces new processes and requires new equipment, will result in increased demand for Intevac's equipment. Intevac expects the transition to patterned media to occur following the implementation of TAMR and Intevac introduced the 200 Lean Gen II etch and deposition system in 2009 which is being used by the industry for patterned media application development.

Approximately one-third of the world's hard disk drives are manufactured in Thailand. In October of 2011 several regions of Thailand experienced severe flooding, causing damage to infrastructure, housing and factories. Disk drive manufacturers' factory production and supply chains have been disrupted and component production has been affected. Western Digital is estimated to be affected the most by the flooding in Thailand with sixty percent of its production temporarily shut down. Seagate Technology reported that hard disk drive supplies will be significantly constrained for several quarters and potentially through the remainder of 2012 until the supply chain recovers to the pre-flood level. Until component availability recovers to the same level prior to the flooding, there may not be a need for Intevac's customers to add additional media production capacity. Based on Intevac's current assessment of the situation, it believes that once these constraints are lifted, Intevac's customers will need new equipment to increase media capacity and will result in increased demand for Intevac's equipment. However, because the situation in Thailand is still evolving uncertainty remains regarding the ultimate impact of this event on the Company.

### ***Hard Disk Drive Equipment Products***

#### *Disk Sputtering Systems*

Disk sputtering is the process of depositing a thin film of various materials on a substrate. Intevac equipment deposits magnetic films, non-magnetic films and protective carbon-based overcoats on disks that are to be used in hard disk drives using sputtering or chemical vapor deposition ( CVD ) technologies.

Intevac's 200 Lean systems began shipping in 2003, and the first 200 Lean Gen II systems shipped in 2008, with the installed base of 200 Lean systems reaching more than 155 systems by the end of 2011. Intevac estimates that approximately 90% of the installed base is used in production with the balance used for research and development.

In 2009, Intevac shipped the first 200 Lean Gen II etch and deposition system to be used for patterned media. Intevac provides a cost-effective solution for high-volume manufacturing by providing new etch and associated process modules on the high-productivity 200 Lean Gen II platform.

#### *Disk Lubrication Systems*

Disk lubrication is the manufacturing step that follows deposition of thin films. During lubrication, a microscopic layer of lubricant is applied to the disk's surface to improve durability and reduce surface friction between the disk and the read/write head assembly.

The Intevac AccuLuber™ lubricates disks by depositing a thin film of lubricant on the disk while it is under vacuum thus eliminating the use of solvents, which are environmentally hazardous and expensive to procure, store and dispose.

#### *Non-Systems Business*

Intevac also provides technology upgrades, spare parts and consumables, installation, maintenance and repair services to Intevac's system customers. Non-system business as a percentage of Equipment revenues was 51% in 2009, 27% in 2010 and 66% in 2011.

#### *Solar Market*

Intevac designs, manufactures and markets capital equipment for the photovoltaic ( PV ) solar manufacturing industry. Today, fossil fuels are used to generate most of the world's electricity supply. Volatile prices, increasing demand, aging generation plants and transmission infrastructure, regulatory impediments, growing environmental concerns, ongoing reliance on foreign energy sources and the desire for energy security are all driving the growing global demand for renewable energy sources such as PV solar electricity.

The cost of electricity generated from PV solar energy is higher than that of electricity generated from traditional energy sources in some markets. To offset the higher costs associated with solar energy and to encourage the adoption of alternative energy supplies, some governments around the world implemented various tax credits and other financial incentives. Although public support for solar subsidies appears to remain positive, significant growth in solar installations has caused some governments, particularly in major European countries, to balance or reduce the cost of solar subsidies relative to other government expenditures. At the same time the cost of solar generated electricity has decreased substantially thus offsetting the reductions in solar subsidies. Over the next few years solar is now being forecasted to approach the cost of some traditional energy sources. The continued focus in the PV market is on the development of high-efficient cell technologies aimed at simultaneously boosting output efficiency rates and reducing production costs. New vacuum process technologies and integrated processing steps are becoming increasingly important as companies search for lower cost manufacturing solutions.

A solar cell (also called photovoltaic or PV cell) is a solid state device that converts the energy of sunlight directly into electricity. Assemblies of cells are used to make solar modules, also known as solar panels. Solar panels have broad-based end market applications for solar farms, integrated building PV arrays, rooftop grids and portable devices.

Currently, there are two prevailing processes for manufacturing PV material: wafer-based crystalline silicon ( c-Si ) solar and thin film solar cell manufacturing processes. More than 85% of solar cells produced are made using c-Si wafers. Thin film coating, the other prevailing manufacturing method, involves applying a deposition process and thin-film coating process onto glass or metal substrates.

#### *Solar Manufacturing Products*

##### *Solar Cell Processing System*

Intevac offers vacuum process manufacturing solutions for c-Si and Copper indium gallium (di)selenide ( CIGS ) thin film applications. Intevac's platform, LEAN SOLAR , was leveraged from Intevac's leading hard disk drive system design and is a high-productivity process equipment solution enabling low-cost solar cell manufacturing and high cell efficiency for both c-Si solar and CIGS (thin film).

In 2009 Intevac began offering processing equipment to PV cell manufacturers for CIGS thin film applications and in 2010 began offering processing equipment for wafer-based c-Si applications. To date, Intevac has shipped two LEAN SOLAR deposition systems.

Intevac is in various stages of development for three vacuum process technology modules for the LEAN SOLAR platform for etching, doping by ion implant and deposition applications. These include LEAN SOLAR NanoTexture , ENERGi ion implant, and integrated physical vapor deposition ( PVD ) modules. Intevac's ENERGi ion implantation module is based upon technology developed by Solar Implant Technologies, Inc. ( SIT ) which was acquired by Intevac in November 2010.

#### *LEAN SOLAR NanoTexture*

Texturing is a method used in solar cell processing as a means of lowering surface reflectance and therefore capturing more light or photons resulting in higher overall solar cell efficiencies. Typically texturing is carried out with wet chemicals such as acids that produce a rough textured surface on the solar cell. The LEAN SOLAR NanoTexture is a dry etch processing system that enables much smaller nano sized texture features in the solar cell that enable lower reflectance and therefore higher cell efficiency. The LEAN SOLAR NanoTexture can be integrated into a standard solar processing line to enable higher cell efficiencies and lower cost per watt. The additional benefit of the NanoTexture process is the cell appearance is changed from a non-uniform grainy blue color to a more desirable uniform black color which will capture more light.

#### *LEAN SOLAR ENERGi*

Ion implantation is a technique being introduced to solar cell lines to replace older diffusion processes as a means to increase overall cell efficiency and lower cost per watt. Ion implantation enables new advanced cell structures with fewer processing steps and therefore at lower cost. The ion implant process developed with Intevac's LEAN SOLAR ENERGi product enables precision engineering of the dopant elements such as phosphorous and boron to form the emitter in the solar cell. The LEAN SOLAR ENERGi ion implanter is being designed to run at high throughput, results in lower cost of ownership in manufacturing and can be integrated into a standard solar processing line.

#### *LEAN SOLAR PVD*

PVD is a process used in multiple steps in the manufacturing of solar cells such as for electrical contacts, conductor layers, reflective layers, transparent conductive oxides and thin film absorber layers all of which are critical to the efficiency of solar cells. The LEAN SOLAR PVD system is versatile in that it can deposit all of these layers for a variety of c-Si PVD applications. The LEAN SOLAR PVD is being designed to run at high throughput and with high target utilization designed to result in lower cost of ownership for solar manufacturers.

#### *Inspection System*

Intevac's NanoVista Photoluminescence Inspection System is used in photovoltaic cell inspection. With high throughput material handling capability and a proprietary, high sensitivity, high resolution camera, NanoVista captures solar cell images in milliseconds with greater accuracy than other imaging systems.

To date Intevac has not recognized significant revenue from its PV products.

#### ***Semiconductor Equipment Market***

Prior to January 2012, Intevac designed, manufactured and marketed vacuum wafer-handling automation equipment to the semiconductor manufacturing industry. In 2010 Intevac introduced a high-productivity vacuum wafer handling system platform which offered customers a cost-effective, flexible alternative to the current cluster platform designs. In 2011 Intevac recognized revenue on the first three wafer handling systems. In January 2012, Intevac divested the semiconductor mainframe technology and sold certain assets comprising its semiconductor mainframe technology to Brooks Automation, Inc.

#### **Intevac Photonics Segment**

##### ***Intevac Photonics Market***

Intevac Photonics develops, manufactures and sells compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and materials identification. These products incorporate high resolution digital image sensors operating in the visible and near infrared (NIR) light spectrums and are based on Intevac's proprietary EBAPS (Electron Bombarded Active Pixel Sensor) technology.

Intevac Photonics products primarily address the high performance military night-vision market. Key applications are focused on the detection and identification of targets in extremely low-light level conditions. Intevac provides these products for military aircraft, ground vehicles, ground soldier head-mounted and weapon-

mounted applications. In addition to military night-vision products, Intevac also develops and manufactures Raman spectrometer systems for the detection and identification of materials in the chemical, biological and explosives threat detection ( CBNRE ), pharmaceutical, plastics and law enforcement industries.

### ***Military Products***

Intevac's EBAPS sensors are incorporated into custom-designed products for high performance military applications. Intevac's EBAPS sensors can be integrated at various levels with optics, electronics, software, and displays based upon customer specifications and requirements. Customization typically occurs in the areas of electronics, near-eye micro-displays, and mechanical packaging. Product configurations include sensors, cameras, and complete systems. Intevac's products by application are:

#### *Rifle Sight*

Intevac offers low-light 1.3 and 2.0 mega-pixel EBAPS modules that are integrated by our customers into a weapon sight attached to weaponry including rifles for night time aiming and targeting.

#### *Helicopter Pilotage*

Intevac offers a night-vision camera with a 2.0 mega-pixel resolution EBAPS module which is gimbal-mounted on the helicopter. The low-light level digital video is then viewable by the helicopter pilot on a head mounted display enabling the pilot to fly at night time and in adverse conditions.

#### *Fixed Wing Aircraft Pilotage*

Intevac offers night-vision cameras with 1.3 and 2.0 mega-pixel resolutions which are embedded into a fighter pilot's helmet and enables the pilot to fly at night time and in adverse conditions.

#### *Long-Range Target Identification*

Intevac offers the Laser Illuminated Viewing and Ranging ( LIVAR® ) shortwave-infrared ( SWIR ), camera for long range military nighttime surveillance systems that can identify targets at distances of up to twenty kilometers. Intevac Photonics' LIVAR camera is incorporated into long range target identification systems manufactured by major defense contractors.

#### *Soldier Mobility*

The U.S. Army is sponsoring the Digital Enhanced Night Vision Goggle ( ENVG-D ) program. This night-vision goggle will integrate a low-light visible sensor with a thermal infrared sensor. The head-mounted digital imaging system will allow low-light level and thermal imagery to be viewed individually, or to be overlaid ( digitally fused ), and enable connectivity to a wireless network for distribution of the imagery and other information.

#### *Simulation and Training*

Near-eye display systems are high-performance, micro-display products for near-eye, portable viewing of video in military and commercial markets. Intevac's eyeglass and helmet-mounted display systems provide high definition and a wide field-of-view in miniaturized light-weight and portable designs. Intevac's I-Port™ helmet-mounted display provides solutions for such diverse markets as medical, industrial, commercial and military, including training and simulation.

### ***Commercial Products***

#### *Raman Materials Identification Instruments*

Products include Raman spectrometer table-top and handheld systems that perform non-destructive identification of solid materials, powders and liquids by illuminating the sample with a laser and measuring the characteristic spectrum of light scattered from the tested sample. Raman spectroscopy can be used in forensics, homeland security, geology, gemology, medical, pharmaceutical and industrial quality assurance applications.



Intevac has developed a series of handheld Raman instruments that incorporate Intevac's core NIR sensors to enable the detection and identification of critical materials in the CBNRE, pharmaceutical, plastics and law enforcement industries.

#### *Low-Light Cameras*

Intevac Photonics' MicroVista® product line of commercial low-light Complementary Metal Oxide Semiconductor ( CMOS ) cameras provides high sensitivity in the ultraviolet, visible or NIR regions of the spectrum. MicroVista's compact and lightweight camera design can be used in industrial inspection, bio-medical and scientific applications. These cameras are primarily sold through distribution channels and to original equipment manufacturers.

#### **Backlog**

Intevac's backlog of orders at December 31, 2011 was \$32.9 million, as compared to \$46.7 million at December 31, 2010. Backlog at December 31, 2011 consisted of \$17.9 million of Equipment backlog and \$15.0 million of Intevac Photonics backlog. Backlog at December 31, 2010 consisted of \$27.3 million of Equipment backlog and \$19.4 million of Intevac Photonics backlog. The decrease in Equipment backlog was primarily the result of decreased orders for 200 Lean disk sputtering systems. Backlog at December 31, 2011 included one LEAN SOLAR system, as compared to two 200 Lean systems and two LEAN SOLAR systems in backlog at December 31, 2010. Backlog includes only customer orders with scheduled delivery dates.

#### **Customer Concentration**

Historically, a significant portion of Intevac's revenue in any particular period has been attributable to sales to a limited number of customers. In 2011, 2010 and 2009 sales to Seagate and Hitachi Global Storage Technologies each accounted for more than 10% of Intevac's revenues. In addition, in 2010 sales to Fuji Electric accounted for more than 10% of Intevac's revenues. In the aggregate, sales to these three customers accounted for 58%, 78% and 58% of revenues in 2011, 2010 and 2009 respectively. Intevac expects that sales of Intevac's products to relatively few customers will continue to account for a high percentage of Intevac's revenues in the foreseeable future.

Foreign sales accounted for 65% of revenue in 2011, 77% of revenue in 2010, and 50% of revenue in 2009. The majority of Intevac's foreign sales are to companies in Asia or to U.S. companies for use in their Asian manufacturing or development operations. Intevac anticipates that foreign sales will continue to be a significant portion of Intevac's Equipment revenues. Intevac's disk sputtering equipment customers include magnetic disk manufacturers, such as Fuji Electric and Showa Denko, and vertically integrated hard disk drive manufacturers, such as Hitachi Global Storage Technology, Seagate, and Western Digital. Intevac's customers' manufacturing facilities are primarily located in California, China, Taiwan, Japan, Malaysia and Singapore.

#### **Competition**

The principal competitive factors affecting the markets for Intevac Equipment products include price, product performance and functionality, ease of integration, customer support and service, reputation and reliability. Intevac has only one major competitor, Canon Anelva, in the hard disk drive equipment market and has historically experienced intense worldwide competition for magnetic disk sputtering equipment. Intevac, only recently entered the PV equipment market, and faces competition from large established global competitors including Applied Materials, Veeco Instruments, Centrotherm Photovoltaics, Roth & Rau AG and Von Ardenne as well as smaller regional competitors and cell module manufacturers that are internally developing manufacturing equipment that may be sold externally in the future. These competitors all have substantially greater financial, technical, marketing, manufacturing and other resources as compared to Intevac. Furthermore, any of Intevac's competitors may develop enhancements to, or future generations of, competitive products that offer superior price or performance features. In addition, new competitors, with enhanced products may enter the markets that Intevac currently serves.

The principal competitive factors affecting Intevac Photonics products include price, extreme low-light level detection performance, power consumption, resolution, size, ease of integration, reliability, reputation and customer support and service. Intevac faces substantial competition for Intevac Photonics products, and many

competitors have substantially greater resources and brand recognition. In the military market, ITT Industries is a large and well-established defense contractor and is a primary U.S. manufacturer of image intensifier tubes used in Generation-III night vision devices and their derivative products. Intevac's digital night vision sensors, cameras and systems are intended to displace Generation-III night vision based products. Intevac expects that ITT, BAE Systems and other companies will develop digital night vision products and aggressively promote their sales. Furthermore, Intevac's LIVAR target identification sensors and cameras face competition from CMC Electronics, DRS, FLIR Systems, Goodrich and Raytheon, established companies that manufacture infrared sensors and cameras which are presently used in long-range target identification systems. Within the near-eye display market, Intevac also faces competition from Rockwell-Collins, Vuzix and BAE, all of which can offer cost-competitive products. In the commercial markets, companies such as Andor, Dalsa, E2V, Hamamatsu and Roper offer competitive sensor and camera products, and companies such as B&W Tek, GE Security, Horiba Jobin Yvon, Ocean Optics, Renishaw, Thermo Scientific and Smiths Detection offer competitive Raman spectrometer products.

### **Marketing and Sales**

Equipment sales are made through Intevac's direct sales force, except in Japan where Intevac sells its products through a distributor, Matsubo. The selling process for Intevac's Equipment products is multi-level and lengthy, involving individuals from marketing, engineering, operations, customer service and senior management.

Installing and integrating new equipment requires a substantial investment by a customer. Sales of Intevac's systems depend, in significant part, upon the decision of a prospective customer to replace obsolete equipment or to increase manufacturing capacity by upgrading or expanding existing manufacturing facilities or by constructing new manufacturing facilities, all of which typically involve a significant capital commitment. After making a decision to select Intevac's equipment, Intevac's customers typically purchase one or more engineering systems to develop and qualify their production process prior to ordering and taking delivery of multiple production systems. Accordingly, Intevac's systems have a lengthy sales cycle, during which Intevac may expend substantial funds and management time and effort with no assurance that a sale will result.

The production of large complex systems requires Intevac to make significant investments in inventory both to fulfill customer orders and to maintain adequate supplies of spare parts to service previously shipped systems. In some cases Intevac manufactures subsystems and/or complete systems prior to receipt of a customer order to smooth Intevac's production flow and/or reduce lead time.

Intevac maintains inventories of spare parts in the United States, Singapore and China to support its Equipment customers. Intevac often requires its Equipment customers to pay for systems in three installments, with a portion of the system price billed upon receipt of an order, a portion of the price billed upon shipment, and the balance of the price and any sales tax due upon completion of installation and acceptance of the system at the customer's factory. All customer product payments are recorded as customer advances, which are released into revenue in accordance with Intevac's revenue recognition policy.

Intevac provides process and applications support, customer training, installation, start-up assistance and emergency service support to Intevac's Equipment customers. Intevac conducts training classes for Intevac's customers' process engineers, machine operators and machine service personnel. Additional training is also given to Intevac's customers during equipment installation. Intevac has field offices in Singapore, China, Taiwan, and Malaysia to support Intevac's customers in Asia. Intevac generally adds additional support centers as necessary to maintain close proximity to Intevac's customers' factories as they deploy Intevac's systems.

Warranties for Intevac's Equipment products typically range between 12 and 24 months from customer acceptance. During the warranty period any necessary non-consumable parts are supplied and installed without charge. Intevac's employees provide field service support in the United States, Singapore, Malaysia, China, Taiwan and Japan. In Japan, field service support is also supplemented by Intevac's distributor, Matsubo.

Sales of Intevac Photonics products for military applications are primarily made to the end user through Intevac's direct sales force. Intevac sells to leading defense contractors such as Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon, DRS Technologies, BAE and Sagem.

Intevac is subject to long sales cycles in the Photonics segment because many of Intevac's products, such as Intevac's night vision systems, typically must be designed into Intevac's customers' products, which are often complex and state-of-the-art. These development cycles are often multi-year, and Intevac's sales are contingent on Intevac's customer successfully integrating Intevac's product into its product, completing development of its product and then obtaining production orders for its product. Sales of these products are also often dependent on ongoing funding of defense programs by the U.S. government and its allies. Additionally, sales to international customers are contingent on issuance of export licenses by the U.S. government.

Sales of Intevac Photonics commercial products are made through a combination of direct sales, system integrators, distributors and value added resellers and can also be subject to long sales cycles.

Intevac Photonics generally invoices its research and development customers either as costs are incurred, or as program milestones are achieved, depending upon the particular contract terms. As a government contractor, Intevac invoices customers using estimated annual rates approved by the Defense Contracts Audit Agency (DCAA).

### **Research and Development and Intellectual Property**

Intevac's long-term growth strategy requires continued development of new products. Intevac works closely with Intevac's global customers to design products that meet their planned technical and production requirements. Product development and engineering organizations are located primarily in the United States and Singapore.

Intevac invested \$34.3 million (41.3% of net revenues) in fiscal 2011, \$27.9 million (13.8% of net revenues) in fiscal 2010, and \$28.1 million (36.0% of net revenues) in fiscal 2009 for product development and engineering programs to create new products and to improve existing technologies and products. Intevac has spent an average of 24.0% of net revenues on product development and engineering over the last five years.

Intevac's competitive position significantly depends on Intevac's research, development, engineering, manufacturing and marketing capabilities, and not just on Intevac's patent position. However, protection of Intevac's technological assets by obtaining and enforcing intellectual property rights, including patents, is important. Therefore, Intevac's practice is to file patent applications in the United States and other countries for inventions that Intevac considers important. Intevac has a substantial number of patents in the United States and other countries, and additional applications are pending for new inventions. Although Intevac does not consider Intevac's business materially dependent upon any one patent, the rights of Intevac and the products made and sold under Intevac's patents along with other intellectual property, including trademarks, know-how, trade secrets and copyrights, taken as a whole, are a significant element of Intevac's business.

Intevac enters into patent and technology licensing agreements with other companies when management determines that it is in Intevac's best interest to do so. Intevac pays royalties under existing patent license agreements for use of certain patented technologies in several of Intevac's products. Intevac also receives, from time to time, royalties from licenses granted to third parties. Royalties received from or paid to third parties have not been material to Intevac's consolidated results of operations.

In the normal course of business, Intevac periodically receives and makes inquiries regarding possible patent infringements. In dealing with such inquiries, it may be necessary or useful for us to obtain or grant licenses or other rights. However, there can be no assurance that such licenses or rights will be available to us on commercially reasonable terms, or at all. If Intevac is not able to resolve or settle claims, obtain necessary licenses and/or successfully prosecute or defend Intevac's position, Intevac's business, financial condition and results of operations could be materially and adversely affected.

### **Manufacturing**

Intevac manufactures its Equipment products at its facilities in California and Singapore. Intevac's Equipment manufacturing operations include electromechanical assembly, vacuum processing, fabrication of sputter sources, and system assembly, alignment and testing.

Intevac Photonics products are manufactured at Intevac's facilities in California and Wyoming. Intevac Photonics manufactures sensors, cameras, integrated camera systems, compact Raman spectrometry instruments and near-eye display systems using advanced manufacturing techniques and equipment. Intevac's operations include vacuum processing, and electromechanical and optical system assembly.

## Employees

At December 31, 2011, Intevac had 429 employees, including 25 contract employees.

## Compliance with Environmental Regulations

Intevac is 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. Intevac treats the cost of complying with government regulations and operating a safe workplace as a normal cost of business and allocates the cost of these activities to all functions, except where the cost can be isolated and charged to a specific function. The environmental standards and regulations promulgated by government agencies in California, Wyoming and Singapore are rigorous and set a high standard of compliance. Intevac believes its costs of compliance with these regulations and standards are comparable to other companies operating similar facilities in these jurisdictions.

## Executive Officers of the Registrant

Certain information about our executive officers as of February 21, 2012 is listed below:

| Name                       | Age | Position                                                                                               |
|----------------------------|-----|--------------------------------------------------------------------------------------------------------|
| <i>Executive Officers:</i> |     |                                                                                                        |
| Norman H. Pond             | 73  | Chairman of the Board                                                                                  |
| Kevin Fairbairn            | 58  | President and Chief Executive Officer                                                                  |
| Jeffrey Andreson           | 50  | Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary |
| Andres Brugal              | 54  | Executive Vice President and General Manager, Intevac Photonics                                        |
| Luke Marusiak              | 49  | Executive Vice President, Chief Operating Officer                                                      |
| Michael Russak             | 65  | Executive Vice President and General Manager, Hard Disk Equipment Products                             |
| Christopher Smith          | 52  | Executive Vice President, Emerging Markets                                                             |
| Kimberly Burk              | 46  | Vice President, Human Resources                                                                        |
| <i>Other Key Officers:</i> |     |                                                                                                        |
| Babak Adibi                | 57  | Vice President and General Manager, Solar Implant                                                      |
| Verle Aebi                 | 57  | Chief Technology Officer, Intevac Photonics                                                            |
| James Birt                 | 47  | Vice President, Manufacturing and Customer Support, Equipment Products                                 |
| Terry Bluck                | 52  | Vice President, Technology, Equipment Products                                                         |
| Timothy Justyn             | 49  | Vice President of Operations, Intevac Photonics                                                        |
| William Maffucci           | 55  | Vice President and General Manager, Intevac Vision Systems Products                                    |
| Edward Murrer              | 62  | Vice President, Business Development, Solar Implant                                                    |

*Mr. Pond* is a founder of Intevac and has served as Chairman of the Board since February 1991. Mr. Pond served as President and Chief Executive Officer from February 1991 until July 2000 and again from September 2001 through January 2002. Mr. Pond holds a BS in physics from the University of Missouri at Rolla and an MS in physics from the University of California at Los Angeles.

*Mr. Fairbairn* joined Intevac as President and Chief Executive Officer in January 2002 and was appointed a director in February 2002. Before joining Intevac, Mr. Fairbairn was employed by Applied Materials from July 1985 to January 2002, most recently as Vice President and General Manager of the Conductor Etch Organization with responsibility for the Silicon and Metal Etch Divisions. From 1996 to 1999, Mr. Fairbairn was General Manager of Applied Materials Plasma Enhanced Chemical Vapor Deposition Business Unit and from 1993 to 1996, he was General Manager of Applied Materials Plasma Silane CVD Product Business Unit. Mr. Fairbairn holds an MA in engineering sciences from Cambridge University.

*Mr. Andreson* joined Intevac in June 2007 and has served as Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary since August 2007. Prior to joining Intevac, Mr. Andreson served as Managing Director and Controller of Applied Materials Global Services product group. Since joining Applied Materials in 1995, Mr. Andreson held a number of senior financial positions, including Managing Director, Global Financial Planning and Analysis; Controller, Metron Subsidiary; Controller, North American Sales and Service; and Controller, Volume Manufacturing. From 1989 through 1995, Mr. Andreson held various roles at Measurix Corporation. Mr. Andreson holds an MBA from Santa Clara University and a BS in finance from San Jose State University.

*Mr. Brugal* joined Intevac as Executive Vice President and General Manager, Intevac Photonics in January 2012. Before joining Intevac, Mr. Brugal was employed at Vision Systems International, a joint venture between Rockwell Collins and Elbit Systems of America, from 2006 to 2012, serving as President and Chief Executive Officer from April 2007 to January 2012. From 2005 to 2006, Mr. Brugal was employed as a consultant for DRS Technologies, a subsidiary of Finmeccanica SPA. Mr. Brugal retired from active service with the U.S. Navy in October 2005 with the rank of Captain. Mr. Brugal holds an MS in strategic studies and security affairs from the U.S. Naval War College; and a BS in general engineering from the U.S. Naval Academy.

*Mr. Marusiak* rejoined Intevac in January 2010 and currently serves as Executive Vice President, Chief Operating Officer. Mr. Marusiak had previously served as Intevac's Chief Operating Officer from 2004 through 2008. From October 2008 through December 2009, Mr. Marusiak served as the Chief Executive Officer of MDC Vacuum Products, LLC. Before joining Intevac, Mr. Marusiak was employed by Applied Materials from July 1991 to April 2004, most recently as Senior Director of North American Operations. From 1984 to 1991, Mr. Marusiak served as a signal officer in the U.S. Army. Mr. Marusiak holds a BS in electrical engineering from Gannon University and an MS in teleprocessing science from the University of Southern Mississippi.

*Dr. Russak* joined Intevac in July 2008 and currently serves as Executive Vice President and General Manager, Hard Disk Equipment Products. Before joining Intevac Dr. Russak served as President and Chief Technical Officer of Komag from 2000 to 2007. From 1993 to 2000, Dr. Russak served as Vice President of Research and Development at HMT Technology. Previously, Dr. Russak held management positions in the Research Division of IBM Corporation. Prior to IBM, Dr. Russak worked for Grumman Aerospace Corporation as a contributing scientist. Dr. Russak holds a BS in ceramic engineering and a PhD in materials science from Rutgers University.

*Mr. Smith* joined Intevac in August 2010 as Executive Vice President, Emerging Markets. Mr. Smith has over 25 years of executive-level experience in the semiconductor and solar capital equipment markets. Prior to joining Intevac, Mr. Smith served as Senior Vice President Sales and Customer Support at Oerlikon Solar, from November 2007 to August 2010. From 2006 to 2007 he served as Senior Vice President of Sales and Service with Cymer. Previously, Mr. Smith was employed by Applied Materials from 1994 to 2006. While at Applied Materials he held a variety of executive-level customer support and operations positions. He also served as product business group general manager for Chemical Mechanical Polishing and was managing director of Global Business Development for the Dielectric and Physical Vapor Deposition Product Business Groups. Mr. Smith earned his BS in Business Administration / Material Management from San Jose State University.

*Ms. Burk* joined Intevac in May 2000 and currently serves as Vice President of Human Resources. Prior to joining Intevac, Ms. Burk served as Human Resources Manager of Moen, Inc. from 1999 to 2000 and as Human Resources Manager of Lawson Mardon from 1994 to 1999. Ms. Burk holds a BS in sociology from Northern Illinois University.

*Dr. Adibi* joined Intevac in November 2010 as Vice President and General Manager, Solar Implant. Prior to joining Intevac, Dr. Adibi was President, Chief Technology Officer and Co-Founder of Solar Implant

Technologies, Inc. Prior to founding Solar Implant Technologies, Inc., Dr. Adibi worked for Silicon Genesis Corporation from 2006 to 2008 as the General Manager of the Solar Equipment Division. From 2003 to 2006 he served as Vice President in the Laser Annealing Product Division of Ultratech, Inc. Previously, Dr. Adibi was employed by Applied Materials from 1985 to 2003. While at Applied Materials he held a variety of executive-level engineering positions. Dr. Adibi holds numerous patents in the area of ion implantation, a PhD in ion implantation and semiconductors and a MS in nuclear power from Surrey University in England and a BS in physics from the Imperial College of London.

*Mr. Aebi* has served as Chief Technology Officer of the Intevac Photonics business since August 2006. Previously, Mr. Aebi served as President of the Photonics Division from July 2000 to July 2006 and as General Manager of the Photonics Division since May 1995. Mr. Aebi was elected as a Vice President of the Company in September 1995. From 1988 through 1994, Mr. Aebi was the Engineering Manager of the night vision business Intevac acquired from Varian Associates in 1991, where he was responsible for new product development in the areas of advanced photocathodes and image intensifiers. Mr. Aebi holds a BS in physics and an MS in electrical engineering from Stanford University.

*Mr. Birt* joined Intevac in September 2004 and currently serves as Vice President, Manufacturing and Customer Support of the Equipment Products Division. Before joining Intevac, Mr. Birt was employed by Applied Materials from July 1992 to September 2004, most recently as Director, Field Operations/Quality North America. Mr. Birt holds a BS in electrical engineering from Texas A&M University.

*Mr. Bluck* rejoined Intevac as Vice President, Technology of the Equipment Products Division in August 2004. Mr. Bluck had previously worked at Intevac from December 1996 to November 2002 in various engineering positions. The business unit Mr. Bluck worked for was sold to Photon Dynamics in November 2002, and he was employed there as Vice President, Rapid Thermal Process Product Engineering until August 2004. Mr. Bluck holds a BS in physics from San Jose State University.

*Mr. Justyn* has served as Vice President of Operations, Intevac Photonics from October 2008. Mr. Justyn served as Vice President, Equipment Manufacturing from April 1997 to October 2008. Mr. Justyn joined Intevac in February 1991 and has served in various roles in our Equipment Products Division and our former night vision business. Mr. Justyn holds a BS in chemical engineering from the University of California, Santa Barbara.

*Mr. Maffucci* joined Intevac in November 2007 as Managing Director of Intevac's Creative Display Systems subsidiary and currently serves as Vice President and General Manager, Intevac Vision Systems Products. Mr. Maffucci was the co-founder, Vice President and Chief Operating Officer of Creative Display Systems until its acquisition by Intevac in 2007. Prior to founding Creative Display Systems, Mr. Maffucci worked for Rockwell-Collins Optronics / Kaiser Electro-Optics from 1993 to 2006 in a variety of executive-level management positions where his most recent position was Sr. Director, Displays Business Unit. Mr. Maffucci holds a BS in Mechanical Engineering from the University of California, Davis.

*Mr. Murrer* joined Intevac in November 2010 as Vice President, Business Development, Solar Implant. Mr. Murrer has over 25 years of executive-level experience in the solar capital equipment and software markets. Prior to joining Intevac, Mr. Murrer was Chairman, Chief Executive Officer and Co-Founder of Solar Implant Technologies, Inc. Prior to founding Solar Implant Technologies, Inc., Mr. Murrer worked for Silicon Genesis Corporation from 2006 to 2008 as Vice President of Marketing and Business Development. From 2003 to 2006 he served as Senior Vice President of Sales and Marketing with Kyberpass, Inc. Previously, Mr. Murrer was employed by Persistence Software from 2001 to 2003. Mr. Murrer holds a BS and a MS in mechanical engineering from the Purdue University.

#### **Available Information**

Intevac's website is <http://www.intevac.com>. Intevac makes available free of charge, on or through its website, its annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing them to, the SEC. This website address is intended to be an inactive textual reference only and none of the information contained on Intevac's website is part of this report or is incorporated by reference herein.

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## Trade Marks

200 Leaf, AccuLuber, DeltaNEAPS ENERGY, ExaminerR, I-Port, LEAN SOLAR, LithoPrime, Vista LNA, Vista NanoTexture Etch, NightVista, Night Port, PHARMA-ID, and RAPID-ID, are our trademarks.

### 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 photovoltaic ( PV ) solar cells. This subjects us to business cycles, the timing, length and volatility of which can be difficult to predict. When demand for commodity technology products exceeds production capacity, then demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of commodity technology products exceeds demand, then demand for new capital equipment such as ours tends to be depressed. For example, sales of systems for magnetic disk production were severely depressed from mid-1998 until mid-2003 and grew rapidly from 2004 through 2006, followed by a downturn in the cycle in late 2007 which continued through 2009. The number of new systems delivered 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.

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 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.***

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 announced in 2011 that it will acquire Hitachi Global Storage Technology. The concentration of our customer base may enable our customers to demand pricing and other terms unfavorable to Intevac, and makes us more vulnerable to changes in demand by a given customer. Orders from a relatively limited number of manufacturers have accounted for, and will likely continue to account for, a substantial portion of our revenues. The loss of one of these large customers, or delays in purchasing by them, could have a material and adverse effect on our revenues.

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

We have invested heavily, and continue to invest, in the development of new products, such as our 200 Lean Gen II system, our 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, cyclicality and other factors in the markets for computer systems, storage subsystems and consumer electronics containing disks our customers produce with our systems; (2) delays or problems in the introduction and acceptance of our new products, or delivery of existing products; (3) timing of orders, acceptance of new systems by our customers or cancellation of those orders; (4) new products, services or technological innovations by our competitors or us; (5) changes in our manufacturing costs and operating expense; (6) changes in general economic, political, stock market and industry conditions; and (7) any failure of our operating results to meet the expectations of investment research analysts or investors.

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.

***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.

***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 and 2011 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 \$57.2 million of taxable income in the United States in order to fully realize the Federal deferred tax assets and \$22.1 million of taxable income in Singapore in order to fully realize the foreign deferred tax assets, each as recorded as of December 31, 2011. If our expectations of future income are incorrect, we could be required to establish a valuation allowance against some or all of the deferred tax assets.

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

The majority of our revenues come from regions outside the United States. Most of our international sales are to customers in Asia, which includes products shipped to overseas operations of U.S. companies. We currently have manufacturing facilities in California, Wyoming and Singapore and international customer support offices in Singapore, 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.

***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 6 Goodwill and Purchased Intangible Assets, Net in the Notes to the 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.

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

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

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

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

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

None.

**Item 2. Properties**

Intevac maintains its corporate headquarters in Santa Clara, California. The location, approximate size and type of facility of the principal properties are listed below. Intevac leases all of its properties and does not own any real estate.

| Location        | Square Footage | Principal Use                                                                                                      |
|-----------------|----------------|--------------------------------------------------------------------------------------------------------------------|
| Santa Clara, CA | 169,583        | Corporate Headquarters; Equipment and Intevac Photonics Marketing, Manufacturing, Engineering and Customer Support |
| Fremont, CA     | 9,505          | Intevac Photonics Sensor Fabrication                                                                               |
| Laramie, WY     | 12,000         | Intevac Photonics Raman Spectrometer Manufacturing                                                                 |
| Carlsbad, CA    | 10,360         | Intevac Photonics Micro Display Product Manufacturing                                                              |
| Singapore       | 31,947         | Equipment Manufacturing and Customer Support                                                                       |
| Malaysia        | 1,291          | Equipment Customer Support                                                                                         |
| Taiwan          | 3,003          | Equipment Customer Support                                                                                         |
| Shenzhen, China | 2,568          | Equipment Customer Support                                                                                         |

Intevac considers these properties adequate to meet its current and future requirements. Intevac regularly assesses the size, capability and location of its global infrastructure and periodically makes adjustments based on these assessments.

**Item 3. Legal Proceedings**

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

**Item 4. Mine Safety Disclosures**

Not applicable

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**PART II**
**Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**  
**Price Range of Common Stock**

Intevac common stock is traded on The Nasdaq Stock Market (NASDAQ Global Select) under the symbol IVAC. As of February 21, 2012, there were 105 holders of record. In fiscal years 2011 and 2010, Intevac did not declare or pay cash dividends to its stockholders. Intevac currently has no plans to declare or pay cash dividends.

The following table sets forth the high and low closing sale prices per share as reported on The Nasdaq Stock Market for the periods indicated.

|                | <b>High</b> | <b>Low</b> |
|----------------|-------------|------------|
| Fiscal 2011:   |             |            |
| First Quarter  | \$ 15.26    | \$ 11.03   |
| Second Quarter | 12.47       | 9.43       |
| Third Quarter  | 10.21       | 6.42       |
| Fourth Quarter | 8.55        | 6.11       |
| Fiscal 2010:   |             |            |
| First Quarter  | \$ 16.82    | \$ 13.63   |
| Second Quarter | 15.48       | 10.48      |
| Third Quarter  | 11.57       | 9.04       |
| Fourth Quarter | 15.25       | 9.73       |

**Recent Sales of Unregistered Securities**

None.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

None.

**Performance Graph**

The following graph compares the cumulative total stockholder return on Intevac's Common Stock with that of the NASDAQ Stock Market Total Return Index, a broad market index published by the Center for Research in Security Prices (CRSP), and the NASDAQ Computer Manufacturers Stock Total Return Index compiled by CRSP. The comparison for each of the periods assumes that \$100 was invested on December 31, 2006 in Intevac's Common Stock, the stocks included in the NASDAQ Stock Market Total Return Index and the stocks included in the NASDAQ Computer Manufacturers Stock Total Return Index. These indices, which reflect formulas for dividend reinvestment and weighting of individual stocks, do not necessarily reflect returns that could be achieved by individual investors.

## COMPARISON OF CUMULATIVE TOTAL RETURN SINCE DECEMBER 31, 2006

## AMONG INTEVAC, NASDAQ STOCK MARKET TOTAL RETURN INDEX AND

## NASDAQ COMPUTER MANUFACTURERS TOTAL RETURN INDEX

|                                                     | 12/31/06 | 12/31/07 | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 |
|-----------------------------------------------------|----------|----------|----------|----------|----------|----------|
| Intevac, Inc.                                       | \$ 100   | \$ 56    | \$ 20    | \$ 44    | \$ 54    | \$ 29    |
| Nasdaq Stock Market Total Return Index              | 100      | 109      | 66       | 95       | 113      | 114      |
| Nasdaq Computer Manufacturers Total<br>Return Index | 100      | 146      | 62       | 135      | 193      | 226      |

**Item 6. Selected Financial Data**

The following selected financial information has been derived from Intevac's historical audited consolidated financial statements and should be read in conjunction with the consolidated financial statements, the accompanying notes and Management's Discussion and Analysis of Financial Condition and Results of Operations for the corresponding fiscal years.

|                            | Year Ended December 31,               |            |             |             |            |
|----------------------------|---------------------------------------|------------|-------------|-------------|------------|
|                            | 2011                                  | 2010       | 2009        | 2008        | 2007       |
|                            | (in thousands, except per share data) |            |             |             |            |
| Net revenues               | \$ 82,974                             | \$ 202,526 | \$ 77,981   | \$ 110,307  | \$ 215,834 |
| Gross profit               | \$ 30,431                             | \$ 87,672  | \$ 32,720   | \$ 43,339   | \$ 96,043  |
| Operating income (loss)    | \$ (30,741)                           | \$ 31,238  | \$ (17,347) | \$ (30,471) | \$ 27,436  |
| Net income (loss)          | \$ (21,975)                           | \$ 28,049  | \$ (10,077) | \$ (15,345) | \$ 27,345  |
| Earnings (loss) per share: |                                       |            |             |             |            |
| Basic                      | \$ (0.96)                             | \$ 1.26    | \$ (0.46)   | \$ (0.71)   | \$ 1.28    |
| Diluted                    | \$ (0.96)                             | \$ 1.22    | \$ (0.46)   | \$ (0.71)   | \$ 1.23    |
| <b>At year end:</b>        |                                       |            |             |             |            |
| Total assets               | \$ 225,821                            | \$ 251,771 | \$ 203,378  | \$ 189,169  | \$ 215,413 |
| Long-term debt             | \$                                    | \$         | \$          | \$          | \$ 1,898   |

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

Management's Discussion and Analysis (MD&A) is intended to facilitate an understanding of Intevac's business and results of operations. This MD&A should be read in conjunction with Intevac's Consolidated Financial Statements and the accompanying Notes to Consolidated Financial Statements included elsewhere in this Form 10-K. The following discussion contains forward-looking statements and should also be read in conjunction with the cautionary statement set forth at the beginning of this Form 10-K. MD&A includes the following sections:

*Overview:* a summary of Intevac's business, measurements and opportunities.

*Results of Operations:* a discussion of operating results.

*Liquidity and Capital Resources:* an analysis of cash flows, sources and uses of cash, contractual obligations and financial position.

*Critical Accounting Policies:* a discussion of critical accounting policies that require the exercise of judgments and estimates.

**Overview**

Intevac provides process manufacturing equipment solutions to the hard disk drive industry and high-productivity process manufacturing equipment and inspection solutions to the photovoltaic ( 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; medical, scientific and security companies; and law enforcement. Intevac reports two segments: Equipment and Intevac Photonics. During the fourth quarter of 2010, Intevac completed the acquisition of the outstanding shares of Solar Implant Technologies, Inc. ( SIT ), a privately-owned, development-stage company, that was creating a manufacturing module for PV applications. During the first quarter of 2012, Intevac sold certain assets comprising its semiconductor mainframe technology to Brooks Automation Inc. ( 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 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 equipment diversification strategy 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.

| Fiscal Year                       | 2011      | 2010       | 2009      | Change                                                   | Change        |
|-----------------------------------|-----------|------------|-----------|----------------------------------------------------------|---------------|
|                                   |           |            |           | 2011 vs. 2010                                            | 2010 vs. 2009 |
|                                   |           |            |           | (in thousands, except percentages and per share amounts) |               |
| Net revenues                      | \$ 82,974 | \$ 202,526 | \$ 77,981 | \$(119,552)                                              | \$ 124,545    |
| Gross profit                      | 30,431    | 87,672     | 32,720    | (57,241)                                                 | 54,952        |
| Gross margin percent              | 36.7%     | 43.3%      | 42.0%     | (6.6) points                                             | 1.3 points    |
| Net income (loss)                 | (21,975)  | 28,049     | (10,077)  | (50,024)                                                 | 38,126        |
| Earnings (loss) per diluted share | \$ (0.96) | \$ 1.22    | \$ (0.46) | \$(2.18)                                                 | \$ 1.68       |

Fiscal 2009 financial results reflected a challenging environment that resulted from the economic slowdown. Demand in the hard disk drive industry was flat compared to fiscal 2008 and Intevac's Equipment customers did not require capacity additions. During fiscal 2009, demand for new equipment resulted primarily from the retirement of some legacy systems and customer research and development activities, including in patterned media. At the end of 2009, however, Intevac's hard drive customers began taking delivery of and ordering additional systems for 2010 capacity needs. In 2009, Intevac Photonics business grew, driven by U.S. government spending plus incorporation of Intevac products into development, pre-production and some early stage production programs.

Fiscal 2010 financial results significantly improved as Intevac's Equipment customers took delivery of systems to increase their production capacity in response to the increasing demand for hard drives resulting from a general increasing demand for digital storage in multiple applications. In fiscal 2010 Intevac also invested heavily in the development of its PV solar manufacturing products and in late 2010, Intevac acquired SIT to develop ion implementation systems for PV cell manufacturing. Net revenues during fiscal 2010 reflected higher equipment sales to disk manufacturers and increased Intevac Photonics' contract research and development ( R&D ) and product sales. Net income during fiscal 2010 reflected higher net revenues, partially offset by higher selling, general and administrative expenses, and higher income tax expense. The increase in selling, general and administrative expenses during fiscal 2010 was primarily a result of variable compensation expenses, legal expenses associated with an arbitration proceeding covering Intevac's holdings of auction rate securities ( ARS ) and transaction costs associated with the acquisition of SIT.

Fiscal 2011 financial results reflected a challenging environment that resulted from consolidations in the hard drive industry, the floods in Thailand, and the impact of U.S. government defense budget delays. Net revenues during fiscal 2011 reflected lower equipment sales to disk manufacturers and lower Intevac Photonics' contract R&D offset in part by higher Intevac Photonics military product sales. Intevac sold fewer 200 Lean systems in fiscal 2011, as Intevac's hard drive customers delayed equipment purchases during the extended regulatory approval process for the acquisitions by Seagate and Western Digital. Also Intevac's hard drive customers had invested heavily in increased production capacity in the previous year, which met some of their 2011 capacity needs. Finally, floods in Thailand resulted in supply chain disruptions for Intevac's hard drive customers. During fiscal 2011, Intevac also continued its efforts to diversify the equipment business and recognized the first revenue on its PV and semiconductor products. For fiscal 2011, Intevac Photonics product revenue from low-light sensors and cameras increased; however, contract R&D revenue declined as certain R&D contracts had been completed in the prior year and contract funding for several large programs was impacted due to delays in U.S. government defense budget approvals. The fiscal 2011 net loss reflected lower net revenues and increased operating expenses from the inclusion of the SIT expenses which was acquired in the fourth quarter of fiscal 2010, offset in-part by reduced variable compensation expenses and recognition of an income tax benefit. During fiscal 2011, the Company did not record compensation expense in association with its profit sharing and executive incentive variable compensation programs as a result of being in a loss position.

In fiscal 2012, Intevac expects to see a recovery in the hard drive business in the second half of the year as the pending industry acquisitions are completed and as the industry recovers from the effects of the Thailand flooding in the fourth quarter of fiscal 2011. 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 customer qualifications on its PV manufacturing products and start to obtain repeat orders from customers. During the first quarter of 2012, Intevac discontinued offering products to the semiconductor industry and sold certain assets which comprised its semiconductor mainframe technology to Brooks.

In fiscal 2012, Intevac expects that Intevac Photonics business levels will grow driven primarily by the recovery of the contract 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.

**Results of Operations***Net revenues*

|                           | Years Ended December 31, |                   |                  | Change<br>2011 vs.<br>2010 | Change<br>2010 vs.<br>2009 |
|---------------------------|--------------------------|-------------------|------------------|----------------------------|----------------------------|
|                           | 2011                     | 2010              | 2009             |                            |                            |
|                           |                          |                   | (in thousands)   |                            |                            |
| Equipment                 | \$ 54,878                | \$ 168,252        | \$ 51,389        | \$ (113,374)               | \$ 116,863                 |
| Intevac Photonics         | 28,096                   | 34,274            | 26,592           | (6,178)                    | 7,682                      |
| <b>Total net revenues</b> | <b>\$ 82,974</b>         | <b>\$ 202,526</b> | <b>\$ 77,981</b> | <b>\$ (119,552)</b>        | <b>\$ 124,545</b>          |

Net revenues consist primarily of sales of equipment used to manufacture thin-film disks and PV cells, and, to a lesser extent, related equipment and system components; revenue from contract research and development related to the development of electro-optical sensors, cameras and systems; and sales of low-light imaging products and table-top and handheld Raman instruments.

The decrease in Equipment revenues in 2011 was due primarily to a decrease in the number of 200 Lean systems delivered. In 2011, Intevac delivered three 200 Lean systems compared to twenty-six 200 Lean systems in 2010 and four 200 Lean systems in 2009. During fiscal 2011 Intevac recognized the first revenue from its PV products. Intevac recognized revenue on the first LEAN SOLAR deposition system for crystalline silicon solar (c-Si) processing applications. Intevac also sold a LEAN SOLAR system for Copper indium gallium (di)selenide (CIGS) thin film applications whereby revenue is being recognized under the installment method of accounting over the next several years. During fiscal 2011 Intevac also recognized revenue from its semiconductor products. During the first quarter of 2012, Intevac discontinued offering products to the semiconductor industry and sold certain assets which comprised its semiconductor mainframe technology to Brooks. Revenues from disk equipment technology upgrades and spare parts decreased in 2011 versus 2010 as Intevac's customers delayed equipment purchases due to the pending industry consolidation as well as reduced need for upgrades in light of the level of new equipment purchased in fiscal 2010. Revenues from disk equipment technology upgrades and spare parts increased in 2010 versus 2009.

Equipment revenues in 2012 are expected to be higher than 2011 levels due to increased capital spending by hard drive customers for capacity additions and increased revenue from Intevac's new PV equipment products. Intevac believes that once the supply chain constraints which resulted from the Thailand floods are lifted, Intevac's customers will need new equipment to ramp media capacity, which will result in increased demand for Intevac's equipment. However, because the situation in Thailand is still evolving uncertainty remains regarding the ultimate impact of this event on the Company. Intevac expects long-term demand for hard disk drives to increase driven by the growth in 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 can vary from year to year and is dependent on the factors noted above.

Intevac Photonics revenues decreased by 18.0% to \$28.1 million in 2011, which consisted of \$21.0 million of product revenue and \$7.1 million of contract R &D revenue. Intevac Photonics revenues of \$34.3 million in 2010 consisted of \$16.0 million of product revenue and \$18.3 million of contract R &D revenue. Intevac Photonics revenues of \$26.6 million in 2009 consisted of \$10.5 million of product revenue and \$16.1 million of contract R &D revenue. The increase in product revenues in both 2011 and 2010 resulted from higher 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 products. The decrease in contract R &D revenue in 2011 was the result of a lower volume of contracts due to the completion of several of Intevac Photonics large development contracts in 2010 and delays in U.S. government defense budget approvals. The increase in contract R &D revenue in 2010 was the result of a higher volume of contracts for additional digital night vision applications. In 2012, Intevac Photonics revenue is expected to grow as a result of 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. 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 backlog of orders at December 31, 2011 was \$32.9 million, as compared to \$46.7 million at December 31, 2010 and \$73.8 million at December 31, 2009. Equipment backlog at December 31, 2011 was \$17.9 million compared to \$27.3 million at December 31, 2010 and \$57.5 million at December 31, 2009. Intevac Photonics backlog at December 31, 2011 was \$15.0 million compared to \$19.4 million at December 31, 2010 and \$16.3 million at December 31, 2009. Equipment backlog at December 31, 2011 included one LEAN SOLAR system, as compared to two 200 Lean systems and two LEAN SOLAR systems at December 31, 2010, and ten 200 Lean systems at December 31, 2009.

Significant portions of Intevac's revenues in any particular period have been attributable to sales to a limited number of customers. In 2011, 2010 and 2009 sales to Seagate and Hitachi Global Storage Technologies each accounted for more than 10% of Intevac's revenues. In addition, in 2010 sales to Fuji Electric accounted for more than 10% of Intevac's revenues. In the aggregate, sales to these three customers accounted for 58%, 78% and 58% of revenues in 2011, 2010 and 2009 respectively. The magnetic disk manufacturing industry consists of a small number of large manufacturers. 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 announced in 2011 that it will acquire Hitachi Global Storage Technology. All of these transactions further concentrated the customer base in the industry.

International sales totaled \$54.1 million, \$155.0 million, and \$39.2 million in 2011, 2010, and 2009, respectively, accounting for 65%, 77%, and 50% of net revenues. The decrease in international sales in 2011 was primarily due to decreases in net revenues from disk sputtering systems, and the increase in international sales in 2010 was primarily due to increases in net revenues from disk sputtering systems. Substantially all of Intevac's international sales are to customers in Asia, which includes products shipped to overseas operations of U.S. companies.

#### Gross margin

|                                     | Years Ended December 31,           |           |           | Change           | Change           |
|-------------------------------------|------------------------------------|-----------|-----------|------------------|------------------|
|                                     | 2011                               | 2010      | 2009      | 2011 vs.<br>2010 | 2010 vs.<br>2009 |
|                                     | (in thousands, except percentages) |           |           |                  |                  |
| Equipment gross profit              | \$ 22,318                          | \$ 79,472 | \$ 23,266 | \$ (57,154)      | \$ 56,206        |
| % of Equipment net revenues         | 40.7%                              | 47.2%     | 45.3%     |                  |                  |
| Intevac Photonics gross profit      | \$ 8,113                           | \$ 8,200  | \$ 9,454  | \$ (87)          | \$ (1,254)       |
| % of Intevac Photonics net revenues | 28.9%                              | 23.9%     | 35.6%     |                  |                  |
| Total gross profit                  | \$ 30,431                          | \$ 87,672 | \$ 32,720 | \$ (57,241)      | \$ 54,952        |
| % of net revenues                   | 36.7%                              | 43.3%     | 42.0%     |                  |                  |

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

Equipment gross margin was 40.7% in 2011 compared to 47.2% in 2010 and 45.3% in 2009. Fiscal 2011 gross margins declined over fiscal 2010 due to lower volume and unabsorbed factory utilization. Fiscal 2010 gross margins improved over fiscal 2009 due to higher revenues and improved factory utilization partially offset by a higher proportion of system shipments, which generally have a lower margin than technology upgrades and spare parts. Gross margins in the Equipment business 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 28.9% in 2011 compared 23.9% in 2010 and 35.6% in 2009. The increase in gross margin in 2011 resulted primarily from improved margins associated with Intevac Photonics' high volume digital night vision production shipments for a NATO customer and lower warranty provisions. The decrease in gross margin in 2010 resulted primarily from lower margins associated with Intevac Photonics' digital night vision product, lower margins on contract R&D and increased warranty provisions. Manufacturing costs for the digital night vision product decreased in 2011 as a result of cost reductions and yield improvements.

*Research and development*

|                                  | Years Ended December 31, |           |                | Change<br>2011 vs.<br>2010 | Change<br>2010 vs.<br>2009 |
|----------------------------------|--------------------------|-----------|----------------|----------------------------|----------------------------|
|                                  | 2011                     | 2010      | 2009           |                            |                            |
|                                  |                          |           | (in thousands) |                            |                            |
| Research and development expense | \$ 34,287                | \$ 27,918 | \$ 28,064      | \$ 6,369                   | \$ (146)                   |

Research and development expense consists primarily of salaries and related costs of employees engaged in and prototype materials used in ongoing research, design and development activities for PV cell manufacturing equipment, disk sputtering equipment, semiconductor equipment and Intevac Photonics products. During the first quarter of 2012, Intevac sold certain assets comprising its semiconductor mainframe technology to Brooks and no longer performs research and development activities for semiconductor equipment.

Research and development spending increased for Equipment during 2011 as compared to 2010 and 2009. The increase in Equipment spending during 2011 was due primarily to increased PV development and the inclusion of SIT which was acquired in the fourth quarter of fiscal 2010. The decrease in Equipment spending during 2010 as compared to 2009 was due primarily to a reduction in spending on semiconductor products.

Research and development spending increased for Intevac Photonics during 2011 as compared to 2010 due primarily to an increase in yield improvement efforts, offset in part by cost containment efforts. Research and development spending decreased for Intevac Photonics during 2010 as compared to 2009 primarily related to decreased spending for the digital night vision camera module for Intevac's military NATO customer as the product transitioned into production. Research and development expenses do not include costs of \$4.9 million, \$12.9 million, and \$9.1 million, in 2011, 2010, and 2009, respectively, which are related to customer-funded contract R&D programs and therefore included in cost of net revenues.

*Selling, general and administrative*

|                                             | Years Ended December 31, |           |                | Change<br>2011 vs.<br>2010 | Change<br>2010 vs.<br>2009 |
|---------------------------------------------|--------------------------|-----------|----------------|----------------------------|----------------------------|
|                                             | 2011                     | 2010      | 2009           |                            |                            |
|                                             |                          |           | (in thousands) |                            |                            |
| Selling, general and administrative expense | \$ 26,885                | \$ 28,516 | \$ 22,003      | \$ (1,631)                 | \$ 6,513                   |

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs. All domestic sales and international sales of disk sputtering products in Asia, with the exception of Japan, are typically made by Intevac's direct sales force, whereas sales in Japan of disk sputtering products and other products are typically made by Intevac's Japanese distributor, Matsubo, which also provides services such as installation, warranty and customer support. Intevac has offices in Singapore, Malaysia, Taiwan and China to support Intevac's equipment customers in Asia.

Selling, general and administrative expenses decreased in 2011 over the amount spent in 2010 due primarily to the reduction in variable compensation accruals offset in part by acquisition-related charges and increased equity compensation expense. Selling, general and administrative expense include costs of \$1.2 million and \$108,000, in 2011 and 2010, respectively, in charges associated with the change in the fair value of the contingent consideration obligations related to the SIT acquisition. Selling, general and administrative expenses increased in 2010 over the amount spent in 2009 due primarily to variable compensation, legal expenses associated with the ARS arbitration and transaction costs associated with the acquisition of SIT, offset in part by lower equity-based compensation expense.

*Impairment of goodwill and intangibles*

At December 31, 2011, Intevac had a total of \$18.4 million of goodwill and \$4.1 million of indefinite life intangible assets. Goodwill in the amount of \$10.5 million is attributed to the Equipment segment. Goodwill in the amount of \$7.9 million is attributed to the Intevac Photonics segment. Goodwill and Intevac's 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 2011, Intevac performed its 2011 annual assessment of impairment which did not result in an



impairment of goodwill or Intevac's indefinite life intangible assets. Intevac's reporting units for goodwill impairment testing purposes are consistent with the reportable segments: Equipment and Intevac Photonics. Intevac tested goodwill for possible impairment by first determining the fair value of the related reporting unit and then comparing this value to the recorded net assets of the reporting unit.

The process of evaluating the potential impairment of goodwill is highly subjective and requires significant judgment. Intevac used two valuation methodologies to determine the fair value for its reporting units, with each approach given equal weighting: the income approach and the market approach. Using the income approach, the fair value of each reporting unit was calculated based on the present value of estimated future cash flows, which were formed by evaluating historical trends, current budgets, operating plans and industry data. Estimates of the future cash flows associated with the businesses are critical to these assessments. The assumptions used in the fair value calculation included revenue growth rates, operating margins, risk adjusted discount rates and future economic and market conditions. Changes in these assumptions based on changed economic conditions or business strategies could result in material impairment charges in future periods. The market approach looked at the valuations of comparable public companies which Intevac selected based upon similar industries and products. Intevac then evaluated the reasonableness of the fair value calculations of the reporting units by reconciling the total of the fair values of the two reporting units to Intevac's total market capitalization, taking into account an appropriate control premium. Intevac compared the carrying value of the reporting units to the fair value calculations.

The results of the test for goodwill impairment, as of October 1, 2011, showed that the estimated fair values of the Equipment and Intevac Photonics reporting units exceeded their carrying values by more than \$15.0 million and \$13.0 million, respectively. There was no impairment of goodwill recorded during the years ended December 31, 2011, 2010 and 2009.

Intevac acquired in-process research and development (IPR&D) of \$4.0 million in connection with the acquisition of SIT in November 2010. The fair value of the IPR&D was determined through estimates and valuation techniques based on the terms of the acquisition. This IPR&D project is the development of Intevac's ENERGi ion implantation process technology module for the LEAN SOLAR platform to be used in the manufacturing of PV solar cells. Intevac expects to complete development on this project in the second half of fiscal 2012. Upon completion of development and establishment of technological feasibility, Intevac will determine and begin amortization of the acquired IPR&D over its useful life.

In conjunction with the annual impairment review, the Company assessed the valuation of the IPR&D from the SIT acquisition. For IPR&D, the review involved determining the present value of future cash flows from the resulting product based on estimates, judgments, and assumptions that management believes are appropriate for the circumstances. Based upon updated management projections related to the IPR&D and on a discounted cash flow model, Intevac determined the fair value of the IPR&D exceeded its carrying value.

Intevac also performed the annual impairment review of a tradename, an indefinite life intangible asset, during the fourth quarter of 2011 using a discounted cash flow model and the relief-from-royalty method. Based on this review, Intevac determined the fair value of the tradename exceeded its carrying value.

Intevac will continue to evaluate the carrying value of goodwill and intangible assets and if it is determined that there is a potential impairment, Intevac may record additional charges which would adversely affect its financial results. For further details, see Note 6 of Notes to Consolidated Financial Statements.

*Interest income and other, net*

|                                | Years Ended December 31, |        |                | Change<br>2011 vs.<br>2010 | Change<br>2010 vs.<br>2009 |
|--------------------------------|--------------------------|--------|----------------|----------------------------|----------------------------|
|                                | 2011                     | 2010   | 2009           |                            |                            |
|                                |                          |        | (in thousands) |                            |                            |
| Interest income and other, net | \$ 635                   | \$ 773 | \$ 1,254       | \$ (138)                   | \$ (481)                   |

Interest income and other, net in 2011 included \$847,000 of interest income on investments and a gain of \$109,000 related to the sale of fixed assets partially offset by \$308,000 in realized losses on the sale of ARS that were sold to the issuers at less than par value as part of tender offers and \$32,000 of foreign currency losses.

Interest income and other, net in 2010 included \$899,000 of interest income on investments, a gain of \$481,000 related to the remeasurement of Intevac's pre-acquisition equity interest in SIT at the acquisition-date fair value, partially offset by \$520,000 of foreign currency losses and \$87,000 in net other expense. Interest income and other, net in 2009 included \$1.4 million of interest income on investments and \$134,000 in net other income, partially offset by \$226,000 of foreign currency losses and \$16,000 in interest expense. The decreases in interest income in 2011 and 2010 were driven by lower interest rates on Intevac's investments.

*Provision for (benefit from) income taxes*

|                                           | Years Ended December 31, |          |            | Change           | Change           |
|-------------------------------------------|--------------------------|----------|------------|------------------|------------------|
|                                           | 2011                     | 2010     | 2009       | 2011 vs.<br>2010 | 2010 vs.<br>2009 |
| Provision for (benefit from) income taxes | \$ (8,131)               | \$ 3,962 | \$ (6,016) | \$ (12,093)      | \$ 9,978         |

(in thousands)

Intevac's effective income tax provision rate was 27.0% for fiscal 2011, 12.4% for fiscal 2010, and 37.4% for fiscal 2009. Intevac's tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits and the effect of permanent differences and adjustments of prior permanent differences. 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 carryforwards, 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.

As of December 31, 2011, on a worldwide basis Intevac has recorded a net deferred tax asset of \$23.9 million. The realization of the deferred tax assets is primarily dependent on Intevac generating sufficient U.S. and foreign taxable income in future fiscal years. Management believes that sufficient positive evidence exists from historical operations and projections of taxable income in future years to conclude that it is more likely than not that the Company will realize its deferred tax assets. Management believes that the valuation allowances for Intevac's deferred tax assets are adequate based on several factors including: (1) degree to which Intevac's 2011 and 2009 losses were attributable to unusual items or charges; (2) long duration of Intevac's deferred tax assets; and (3) expectation of improved earnings in the long term.

During 2009, Intevac established an additional valuation allowance to fully reserve its California state deferred tax assets due to the impact of California tax legislation that was enacted in February 2009. This additional valuation allowance decreased the income tax benefit by \$1.0 million. Intevac recognized the effect of the change in valuation allowance as a discrete item.

**Business Combinations**

On November 19, 2010, Intevac acquired the outstanding shares of Solar Implant Technologies, Inc. (SIT), a privately-owned, development stage company, developing an ion implant module to be used in the manufacturing of PV solar cells. Intevac's primary reasons for this acquisition were to complement its existing product offerings and to provide opportunities for future growth. The preliminary aggregate purchase price was \$12.4 million, which consisted of an initial cash payment totaling \$2.7 million and contingent consideration obligations with a fair value of \$9.7 million payable in cash based on the achievement of certain product development milestones achieved over a specified period and revenue earnout on Intevac's net revenue from commercial sales of certain products achieved over a specified period. On July 21, 2011, Intevac made \$2.4 million in payments to the selling shareholders for achievement of the first milestone.

For further details, see Note 7 of Notes to Consolidated Financial Statements.

## Recent Accounting Pronouncements

In September 2011, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance that allows entities to first assess qualitatively whether it is necessary to perform the two-step goodwill impairment test. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative two-step goodwill impairment test is required. An entity has the unconditional option to bypass the qualitative assessment and proceed directly to performing the first step of the goodwill impairment test. The guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. Intevac does not expect the adoption of these provisions to have a significant effect on its consolidated financial statements.

In June 2011, the FASB issued authoritative guidance that amends the presentation requirements for comprehensive income in financial statements. The guidance requires entities to report components of comprehensive income either as part of a single continuous statement of comprehensive income that would combine the components of net income and other comprehensive income, or in a separate, but consecutive, statement following the statement of income. The guidance is effective for interim and annual periods beginning after December 15, 2011 and is to be applied retrospectively. Intevac does not expect the adoption of these provisions to have a significant effect on its consolidated financial statements.

In May 2011, the FASB issued authoritative guidance that amends the existing requirements for fair value measurement and disclosure. The guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy and requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for measurement of the fair value of financial assets and liabilities as well as instruments classified in stockholders' equity. The guidance is effective for interim and annual periods beginning after December 15, 2011. Intevac does not expect the adoption of these provisions to have a significant effect on its consolidated financial statements.

## Liquidity and Capital Resources

At December 31, 2011, Intevac had \$114.8 million in cash, cash equivalents, and investments compared to \$137.4 million at December 31, 2010. During fiscal 2011, cash, cash equivalents and investments decreased by \$22.6 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 Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

Cash, cash equivalents and investments consist of the following:

|                                              | December 31,<br>2011 | December 31,<br>2010 |
|----------------------------------------------|----------------------|----------------------|
|                                              | (In thousands)       |                      |
| Cash and cash equivalents                    | \$ 23,560            | \$ 109,520           |
| Short-term investments                       | 58,585               | 4,994                |
| Long-term investments                        | 32,677               | 22,866               |
| Total cash, cash-equivalents and investments | \$ 114,822           | \$ 137,380           |

Cash used by operating activities totaled \$16.3 million in 2011. Cash generated by operating activities totaled \$51.3 million in 2010. Cash used by operating activities totaled \$16.6 million in 2009. Lower operating cash flow in 2011 was a result of the net loss adjusted to exclude the effect of non-cash charges including, depreciation, amortization, changes in the fair value of acquisition-related contingent consideration and equity-based compensation. This decrease in cash from operating activities was partially offset by changes in working capital. Intevac continues to carefully manage working capital.

Accounts receivable totaled \$18.6 million at December 31, 2011 compared to \$25.9 million at December 31, 2010. The number of days outstanding for Intevac's accounts receivable was 88 at December 31, 2011 compared to 62 at December 31, 2010. The decrease in the receivable balance was due

primarily to lower business levels. The increase in days outstanding was due primarily to lower business levels and customer deposits billed late in 2011. Net inventories totaled \$18.1 million at December 31, 2011 compared to \$20.7 million at December 31, 2010. Inventory turns were 2.7 in fiscal 2011 compared to 5.8 in fiscal 2010. The decrease in the inventory balance and the decline in turns were due primarily to lower manufacturing activities. Accounts payable totaled \$4.9 million at December 31, 2011 compared to \$5.6 million at December 31, 2010. The decrease of \$705,000 relates to the decrease in inventory purchases as a result of lower business levels. Accrued payroll and related liabilities decreased by \$7.2 million during 2011 to \$4.2 million primarily related to payment of 2010 bonuses and profit sharing. Customer advances increased from \$4.9 million at December 31, 2010 to \$5.1 million at December 31, 2011.

Investing activities used cash of \$70.2 million in 2011, generated cash of \$37.7 million in 2010, and used cash of \$4.1 million in 2009. In 2011, purchases of investments, net of proceeds from sales and maturities, totaled \$64.9 million. In 2010, proceeds from sales and maturities of investments, net of purchases, totaled \$47.4 million. In 2009, purchases of investments, net of proceeds from sales and maturities, totaled \$1.5 million. During 2010, Intevac acquired the outstanding shares of SIT for a preliminary aggregate purchase price of \$12.4 million, which consisted of an initial cash payment totaling \$2.7 million and a contingent consideration obligation with a fair value of \$9.7 million payable in cash.

Financing activities generated cash of \$535,000 in 2011 and \$2.9 million in 2010, and used cash of \$809,000 in 2009. 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 July 21, 2011, Intevac made \$2.4 million in payments to the selling shareholders of SIT for achievement of the first milestone. Subsequent to the SIT acquisition, Intevac paid in full \$177,000 in notes payable to certain selling shareholders assumed upon the acquisition. In 2009, Intevac made a scheduled payment of \$2.0 million to the former owners of DeltaNu. The sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans provided \$2.9 million in 2011, \$2.8 million in 2010, and \$1.1 million in 2009. On January 6, 2012, the Company sold certain assets which comprised its semiconductor mainframe technology for \$3.0 million in cash to Brooks Automation Inc. ( Brooks ).

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 variable rate demand notes ( VRDNs ). Intevac regularly monitors the credit risk in its investment portfolio and takes measures, which may include the sale of certain securities, to manage such risks in accordance with its investment policies.

As of December 31, 2011, Intevac's available-for-sale securities included \$4.9 million par value of auction rate securities ( ARS ), less a temporary valuation adjustment of \$410,000 to reflect their current lack of liquidity. Management believes that the impairment of the ARS investments is temporary. Due to current market conditions, these investments have experienced failed auctions beginning in mid-February 2008. These failed auctions result in a lack of liquidity in the securities, but do not affect the underlying collateral of the securities. Intevac does not anticipate that any potential lack of liquidity in these ARS will affect its ability to finance its operations and planned capital expenditures. Intevac continues to monitor efforts by the financial markets to find alternative means for restoring the liquidity of these investments. These investments are classified as non-current assets until Intevac has better visibility as to when their liquidity will be restored. The classification and valuation of these securities will continue to be reviewed quarterly. During 2011, Intevac participated in three tender offers, sold ARS with par values of \$5.5 million, collected \$5.2 million and recognized realized losses on the sales of \$308,000. Additionally, during 2011, \$500,000 of ARS were redeemed at par.

As described in Note 8 of Notes to Consolidated Financial Statements, the fair value of the ARS was estimated at \$4.5 million using discounted cash flow models. The estimates of future cash flows are based on certain key assumptions, such as discount rates appropriate for the type of asset and risk, which are significant unobservable inputs. There was insufficient observable market information for the ARS held by Intevac to determine the fair value. Therefore Level 3 fair values were estimated for these securities by incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included credit quality, collateralization, final stated maturity, estimates of the probability of being called or becoming liquid prior to final maturity, redemptions of similar ARS, previous market activity for the same investment security, impact due to extended periods of maximum auction rates and valuation models.

On July 27, 2010, as a result of a favorable ruling from the Financial Industry Regulatory Authority arbitration panel, Intevac received \$54.8 million from the repurchase of by Citigroup of previously held ARS at par including interest.

As of December 31, 2011, approximately \$10.9 million of cash and cash equivalents and \$17.6 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 Intevac's existing cash, cash equivalents and investments will be sufficient to meet Intevac's cash requirements for the next 12 months. Intevac intends to undertake approximately \$5.0 - \$6.0 million in capital expenditures during the next 12 months.

### Contractual Obligations

The following table summarizes Intevac's contractual obligations as of December 31, 2011:

|                                         | Total     | Payments due by period |                             |           |           |
|-----------------------------------------|-----------|------------------------|-----------------------------|-----------|-----------|
|                                         |           | < 1 Year               | 1-3 Years<br>(in thousands) | 3-5 Years | > 5 Years |
| Operating lease obligations             | \$ 10,234 | \$ 2,347               | \$ 3,945                    | \$ 3,541  | \$ 401    |
| Purchase obligations and commitments(1) | 8,521     | 8,521                  |                             |           |           |
| Other long-term liabilities(2, 4)       | 958       | 958                    |                             |           |           |
| Total(3, 4)                             | \$ 19,713 | \$ 11,826              | \$ 3,945                    | \$ 3,541  | \$ 401    |

(1) Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on Intevac and that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty. These purchase obligations are related principally to inventory and other items.

(2) Intevac is unable to reliably estimate the timing of future payments related to uncertain tax positions; therefore, \$4.2 million of unrecognized tax benefits has been excluded from the table above.

(3) Total excludes contractual obligations already recorded on the consolidated balance sheet as current liabilities (except other long-term liabilities) and certain purchase obligations.

(4) Total excludes contingent consideration that may be paid pursuant to asset purchases or business combinations.

### Off-Balance Sheet Arrangements

As of December 31, 2011, Intevac did not have any material off-balance sheet arrangements (as defined in Item 303(a)(4)(ii) of Regulation S-K).

### Critical Accounting Policies

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. Note 1 of Notes to Consolidated Financial Statements describes the significant accounting policies used in the preparation of the consolidated financial statements. Certain of these significant accounting policies are considered to be critical accounting policies.

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A critical accounting policy is defined as one that is both material to the presentation of Intevac's consolidated financial statements and requires management to make difficult, subjective or complex judgments that could have a material effect on Intevac's financial condition or results of operations. Specifically, these

policies 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 became 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. These uncertainties are discussed in the section above entitled "Risk Factors." Based on a critical assessment of its 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 accounting principles generally accepted in the United States of America, and provide a meaningful presentation of Intevac's financial condition and results of operations.

Management believes that the following are critical accounting policies:

### ***Revenue Recognition***

Intevac recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have passed to Intevac's customer or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Intevac's shipping terms are customarily FOB shipping point or equivalent terms. Intevac's revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment, Intevac recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer acceptance; and (3) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred until delivery of the deferred elements. When a sales arrangement contains multiple elements, Intevac allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its vendor specific evidence (VSOE) if available, third party evidence (TPE) if VSOE is not available, or best estimate of selling price (ESP) if neither VSOE nor TPE is available. Intevac generally utilizes the ESP due to the nature of its products. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements, usually split between delivery of the parts and installation on the customer's systems. In these cases, Intevac recognizes revenue for the relative sales price of the parts upon shipment and transfer of title, and recognizes revenue for the relative sales price of installation services when those services are completed. Revenue related to sales of spare parts is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services. In addition, Intevac uses the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in management's judgment the degree of collectibility is uncertain.

Intevac performs research and development work under various government-sponsored research contracts. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. Intevac considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on fixed-price contracts is recognized on a milestone method or percentage-of-completion method of contract accounting. For contracts structured as milestone agreements, revenue is recognized when a specified milestone is achieved, provided that (1) the milestone event is substantive in nature and there is substantial uncertainty about the achievement of the milestone at the inception of the agreement, (2) the milestone payment is non-refundable, and (3) there is no continuing performance obligations associated with the milestone payment. Any milestone payments received prior to satisfying these revenue recognition criteria are deferred. Intevac generally determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected through completion of the contract. When estimates of total costs to be incurred on a contract exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

### ***Inventories***

Inventories are valued using average actual costs and are stated at the lower of cost or market. The carrying value of inventory is reduced for estimated obsolescence by the difference between its cost and the estimated market value based upon assumptions about future demand. Intevac evaluates the inventory carrying value for potential excess and obsolete inventory exposures by analyzing historical and anticipated demand. In addition, inventories are evaluated for potential obsolescence due to the effect of known and anticipated engineering change orders and new products. If actual demand were to be substantially lower than estimated, additional inventory adjustments for excess or obsolete inventory might be required, which could have a material adverse effect on Intevac's business, financial condition and results of operations.

### ***Warranty***

Intevac estimates the costs that may be incurred under the warranty it provides and records a liability in the amount of such costs at the time the related revenue is recognized. Estimated warranty costs are determined by analyzing specific product and historical configuration statistics and regional warranty support costs. Intevac's warranty obligation is affected by product failure rates, material usage, and labor costs incurred in correcting product failures during the warranty period. As Intevac's customer service engineers and process support engineers are highly trained and deployed globally, labor availability is a significant factor in determining labor costs. The quantity and availability of critical replacement parts is another significant factor in estimating warranty costs. Unforeseen component failures or exceptional component performance can also result in changes to warranty costs. If actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required.

### ***Income Taxes***

Intevac accounts for income taxes by recognizing deferred tax assets and liabilities using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities, net operating losses and tax credit carryforwards. Deferred tax assets are also reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. Management has determined that it is more likely than not that its future taxable income will be sufficient to realize its deferred tax assets.

The effective tax rate is highly dependent upon the geographic composition of worldwide earnings, tax regulations governing each region, non-tax deductible expenses and availability of tax credits. Management carefully monitors the changes in many factors and adjusts the effective income tax rate as required. If actual results differ from these estimates, Intevac could be required to record a valuation allowance on deferred tax assets or adjust its effective income tax rate, which could have a material adverse effect on Intevac's business, financial condition and results of operations.

The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with Intevac's expectations could have a material impact on Intevac's results of operations and financial condition.

### ***Valuation of IPR&D, Contingent Consideration, Goodwill and Other Intangible Assets***

The purchase price of an acquired business is allocated, as applicable, between in-process research and development (IPR&D), other identifiable intangible assets, net tangible assets and goodwill. IPR&D is defined as the value assigned to those projects for which the related products have no alternative future use. Determining the portion of the purchase price allocated to IPR&D and other intangible assets requires the Company to make significant estimates. The amount of the purchase price allocated to IPR&D and other intangible assets is determined by estimating the future cash flows of each project or technology and discounting the net cash flows back to their present values. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. For IPR&D, these valuation methodologies include consideration of the risk of the project not achieving commercial feasibility.

Contingent consideration is recorded at the acquisition date at the estimated fair value of the contingent payments. The acquisition date fair value is measured based on the consideration expected to be transferred (probability-weighted), discounted back to present value. The discount rate used is determined at the time of the

acquisition in accordance with accepted valuation methods. The fair value of the contingent consideration is remeasured at the estimated fair value at each reporting period with the change in fair value recognized as income or expense in the consolidated statements of operations.

Goodwill represents the excess of the aggregate purchase price over the fair value of net assets, including IPR&D, of acquired businesses. Intevac's methodology for allocating the purchase price relating to purchase acquisitions is determined through established and generally accepted valuation techniques. Goodwill is measured as the excess of the cost of the acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. Intevac assigns assets acquired (including goodwill) and liabilities assumed to a reporting unit as of the date of acquisition.

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. For goodwill, Intevac performs a two-step impairment test. In the first step, Intevac compares the fair value of each reporting unit to its carrying value. Intevac's reporting units are consistent with the reportable segments identified in Note 12, based on the manner in which Intevac operates its business and the nature of those operations. Depending on the facts and circumstances Intevac determines the fair value of each of its reporting units based upon the most appropriate valuation technique using the income approach, the market approach or a combination thereof. The income and market approaches were selected as management believes these approaches generally provide the most reliable indications of fair value when the value of the operations is more dependent on the ability to generate earnings than on the value of the assets used in the production process. Under the income approach Intevac calculates the fair value of the reporting units based on the present value of estimated future cash flows. Under the market approach Intevac estimates the fair value based on market multiples of revenue or earnings for comparable companies. Each valuation technique has advantages and drawbacks, which must be considered when applying those techniques. The income approach closely correlates to management's expectations of future results but requires significant assumptions which can be highly sensitive. The market approach is relatively straightforward to measure, but it may be difficult to find directly comparable companies in the marketplace. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then Intevac would perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, Intevac would record an impairment loss equal to the difference. No impairment charges were recognized in fiscal 2011, 2010 and 2009.

#### ***Equity-Based Compensation***

Intevac records compensation expense for equity-based awards under Accounting Standards Codification (ASC) 718, Compensation-Stock Compensation, using the Black-Scholes option pricing model. This model requires Intevac to estimate the expected volatility of the price of Intevac's common stock and the expected life of the equity-based awards. ASC 718 also requires forfeiture estimates of equity-based awards. Estimating volatility, expected life and forfeitures requires significant judgment and an analysis of historical data. Intevac may have to increase or decrease compensation expense for equity-based awards if actual results differ significantly from Intevac's estimates.

#### **Item 7A. *Quantitative and Qualitative Disclosures About Market Risk***

***Interest rate risk.*** Intevac's exposure to market risk for changes in interest rates relates primarily to its investment portfolio. Intevac does not use derivative financial instruments in Intevac's investment portfolio. 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 December 31, 2011.

|                               | 2012                               | 2013      | 2014 | 2015 | 2016 | Beyond   | Total      | Fair Value |
|-------------------------------|------------------------------------|-----------|------|------|------|----------|------------|------------|
|                               | (In thousands, except percentages) |           |      |      |      |          |            |            |
| <b>Cash equivalents</b>       |                                    |           |      |      |      |          |            |            |
| Fixed rate amounts            | \$ 4,447                           |           |      |      |      |          | \$ 4,447   | \$ 4,447   |
| Weighted-average rate         | 0.44%                              |           |      |      |      |          |            |            |
| Variable rate amounts         | \$ 4,845                           |           |      |      |      |          | \$ 4,845   | \$ 4,845   |
| Weighted-average rate         | 0.11%                              |           |      |      |      |          |            |            |
| <b>Short-term investments</b> |                                    |           |      |      |      |          |            |            |
| Fixed rate amounts            | \$ 54,649                          |           |      |      |      |          | \$ 54,649  | \$ 54,688  |
| Weighted-average rate         | 3.01%                              |           |      |      |      |          |            |            |
| Variable rate amounts         | \$ 3,897                           |           |      |      |      |          | \$ 3,897   | \$ 3,897   |
| Weighted-average rate         | 0.28%                              |           |      |      |      |          |            |            |
| <b>Long-term investments</b>  |                                    |           |      |      |      |          |            |            |
| Fixed rate amounts            |                                    | \$ 28,227 |      |      |      | \$ 4,900 | \$ 33,127  | \$ 32,677  |
| Weighted-average rate         |                                    | 2.17%     |      |      |      | 1.40%    |            |            |
| Total investment portfolio    | \$ 67,838                          | \$ 28,227 |      |      |      | \$ 4,900 | \$ 100,965 | \$ 100,554 |

At December 31, 2011, Intevac held investments in ARS. With the liquidity issues experienced in global credit and capital markets, Intevac's ARS have experienced multiple failed auctions. Intevac continues to earn interest at the maximum contractual rate for each security. The estimated values of the ARS held by Intevac are no longer at par. As of December 31, 2011, Intevac had \$4.5 million in ARS in the consolidated balance sheet, which is net of an unrealized loss of \$410,000. The unrealized loss is included in other comprehensive income, as the decline in value is deemed to be temporary due primarily to Intevac's ability and intent to hold these securities long enough to recover their values and that it is more likely than not that Intevac would not be required to sell these ARS before recovery in their par values.

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

**Foreign exchange risk.** From time to time, Intevac enters into foreign currency forward exchange contracts to economically hedge certain of Intevac's 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. Intevac had no foreign currency forward exchange contracts during any of the years ended December 31, 2011, 2010 and 2009.

**Item 8. *Financial Statements and Supplementary Data***

**INTEVAC, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Intevac, Inc.

We have audited the accompanying consolidated balance sheets of Intevac, Inc. (a Delaware corporation) and subsidiaries (collectively, the Company ) as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Intevac, Inc. and subsidiaries as of December 31, 2011 and 2010 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2011 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 21, 2012 expressed an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

/s/ GRANT THORNTON LLP

San Jose, California

February 21, 2012

## INTEVAC, INC.

## CONSOLIDATED BALANCE SHEETS

|                                                                                                                               | December 31,<br>2011      2010<br>(In thousands, except par<br>value) |                   |
|-------------------------------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------|-------------------|
| <b>ASSETS</b>                                                                                                                 |                                                                       |                   |
| Current assets:                                                                                                               |                                                                       |                   |
| Cash and cash equivalents                                                                                                     | \$ 23,560                                                             | \$ 109,520        |
| Short-term investments                                                                                                        | 58,585                                                                | 4,994             |
| Trade, notes and other accounts receivable, net of allowances of \$41 and \$55 at December 31, 2011 and 2010, respectively .. | 18,561                                                                | 25,911            |
| Inventories                                                                                                                   | 18,070                                                                | 20,671            |
| Prepaid expenses and other current assets                                                                                     | 7,114                                                                 | 6,630             |
| Deferred income tax assets                                                                                                    | 2,202                                                                 | 3,124             |
| <b>Total current assets</b>                                                                                                   | <b>128,092</b>                                                        | <b>170,850</b>    |
| Property, plant and equipment, net                                                                                            | 14,449                                                                | 13,918            |
| Long-term investments                                                                                                         | 32,677                                                                | 22,866            |
| Goodwill                                                                                                                      | 18,389                                                                | 18,389            |
| Other intangible assets, net of amortization of \$2,344 and \$1,801 at December 31, 2011 and 2010, respectively               | 6,441                                                                 | 6,984             |
| Deferred income taxes and other long-term assets                                                                              | 25,773                                                                | 18,764            |
| <b>Total assets</b>                                                                                                           | <b>\$ 225,821</b>                                                     | <b>\$ 251,771</b> |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>                                                                                    |                                                                       |                   |
| Current liabilities:                                                                                                          |                                                                       |                   |
| Accounts payable                                                                                                              | \$ 4,857                                                              | \$ 5,562          |
| Accrued payroll and related liabilities                                                                                       | 4,205                                                                 | 11,365            |
| Other accrued liabilities                                                                                                     | 9,887                                                                 | 11,104            |
| Customer advances                                                                                                             | 5,040                                                                 | 4,867             |
| <b>Total current liabilities</b>                                                                                              | <b>23,989</b>                                                         | <b>32,898</b>     |
| Other long-term liabilities                                                                                                   | 9,922                                                                 | 11,630            |
| Commitments and contingencies                                                                                                 |                                                                       |                   |
| Stockholders' equity:                                                                                                         |                                                                       |                   |
| Undesignated preferred stock, \$0.001 par value, 10,000 shares authorized, no shares issued and outstanding                   |                                                                       |                   |
| Common stock, \$0.001 par value :                                                                                             |                                                                       |                   |
| Authorized shares 50,000 issued and outstanding shares 23,122 and 22,558 at December 31, 2011 and 2010, respectively          | 23                                                                    | 23                |
| Additional paid-in-capital                                                                                                    | 146,307                                                               | 139,824           |
| Accumulated other comprehensive income                                                                                        | 414                                                                   | 255               |
| Retained earnings                                                                                                             | 45,166                                                                | 67,141            |
| <b>Total stockholders' equity</b>                                                                                             | <b>191,910</b>                                                        | <b>207,243</b>    |
| <b>Total liabilities and stockholders' equity</b>                                                                             | <b>\$ 225,821</b>                                                     | <b>\$ 251,771</b> |

See accompanying notes.



## INTEVAC, INC.

## CONSOLIDATED STATEMENTS OF OPERATIONS

|                                      | Years Ended December 31,                 |            |             |
|--------------------------------------|------------------------------------------|------------|-------------|
|                                      | 2011                                     | 2010       | 2009        |
|                                      | (In thousands, except per share amounts) |            |             |
| Net revenues:                        |                                          |            |             |
| Systems and components               | \$ 75,850                                | \$ 184,217 | \$ 61,893   |
| Technology development               | 7,124                                    | 18,309     | 16,088      |
| Total net revenues                   | 82,974                                   | 202,526    | 77,981      |
| Cost of net revenues:                |                                          |            |             |
| Systems and components               | 47,601                                   | 101,975    | 36,172      |
| Technology development               | 4,942                                    | 12,879     | 9,089       |
| Total cost of net revenues           | 52,543                                   | 114,854    | 45,261      |
| Gross profit                         | 30,431                                   | 87,672     | 32,720      |
| Operating expenses:                  |                                          |            |             |
| Research and development             | 34,287                                   | 27,918     | 28,064      |
| Selling, general and administrative  | 26,885                                   | 28,516     | 22,003      |
| Total operating expenses             | 61,172                                   | 56,434     | 50,067      |
| Operating income (loss)              | (30,741)                                 | 31,238     | (17,347)    |
| Interest income                      | 847                                      | 899        | 1,362       |
| Other income (expense), net          | (212)                                    | (126)      | (108)       |
| Income (loss) before income taxes    | (30,106)                                 | 32,011     | (16,093)    |
| Provision (benefit) for income taxes | (8,131)                                  | 3,962      | (6,016)     |
| Net income (loss)                    | \$ (21,975)                              | \$ 28,049  | \$ (10,077) |
| Net income (loss) per share:         |                                          |            |             |
| Basic                                | \$ (0.96)                                | \$ 1.26    | \$ (0.46)   |
| Diluted                              | \$ (0.96)                                | \$ 1.22    | \$ (0.46)   |
| Weighted average shares outstanding: |                                          |            |             |
| Basic                                | 22,903                                   | 22,340     | 21,975      |
| Diluted                              | 22,903                                   | 22,977     | 21,975      |

See accompanying notes.

## INTEVAC, INC.

## CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY AND COMPREHENSIVE INCOME (LOSS)

(In thousands)

|                                                                       | Common Stock |        | Additional<br>Paid-In<br>Capital | Accumulated<br>Other<br>Comprehensive<br>Income (Loss) | Retained<br>Earnings | Total<br>Stockholders<br>Equity |
|-----------------------------------------------------------------------|--------------|--------|----------------------------------|--------------------------------------------------------|----------------------|---------------------------------|
|                                                                       | Shares       | Amount |                                  |                                                        |                      |                                 |
| Balance at December 31, 2008                                          | 21,805       | \$ 22  | \$ 128,686                       | \$ (4,808)                                             | \$ 49,169            | \$ 173,069                      |
| Shares issued in connection with:                                     |              |        |                                  |                                                        |                      |                                 |
| Exercise of stock options                                             | 34           |        | 223                              |                                                        |                      | 223                             |
| Employee stock purchase plan                                          | 240          |        | 899                              |                                                        |                      | 899                             |
| Income tax benefits realized from activity<br>in employee stock plans |              |        | 69                               |                                                        |                      | 69                              |
| Equity-based compensation expense                                     |              |        | 4,194                            |                                                        |                      | 4,194                           |
| Net loss                                                              |              |        |                                  |                                                        | (10,077)             | (10,077)                        |
| Unrealized gain on securities held as available-for-sale              |              |        |                                  | 4,371                                                  |                      | 4,371                           |
| Deferred taxes on unrealized gain on available-for-sale<br>securities |              |        |                                  | (1,529)                                                |                      | (1,529)                         |
| Foreign currency translation adjustment                               |              |        |                                  | 138                                                    |                      | 138                             |
| Comprehensive loss                                                    |              |        |                                  |                                                        |                      | (7,097)                         |
| Balance at December 31, 2009                                          | 22,079       | \$ 22  | \$ 134,071                       | \$ (1,828)                                             | \$ 39,092            | \$ 171,357                      |
| Shares issued in connection with:                                     |              |        |                                  |                                                        |                      |                                 |
| Exercise of stock options                                             | 224          | 1      | 1,740                            |                                                        |                      | 1,741                           |
| Employee stock purchase plan                                          | 255          |        | 1,027                            |                                                        |                      | 1,027                           |
| Net income tax detriment from activity in employee stock<br>plans     |              |        | (279)                            |                                                        |                      | (279)                           |
| Equity-based compensation expense                                     |              |        | 3,265                            |                                                        |                      | 3,265                           |
| Net income                                                            |              |        |                                  |                                                        | 28,049               | 28,049                          |
| Unrealized gain on securities held as available-for-sale              |              |        |                                  | 3,072                                                  |                      | 3,072                           |
| Deferred taxes on unrealized gain on available-for-sale<br>securities |              |        |                                  | (1,075)                                                |                      | (1,075)                         |
| Foreign currency translation adjustment                               |              |        |                                  | 86                                                     |                      | 86                              |
| Comprehensive income                                                  |              |        |                                  |                                                        |                      | 30,132                          |
| Balance at December 31, 2010                                          | 22,558       | \$ 23  | \$ 139,824                       | \$ 255                                                 | \$ 67,141            | \$ 207,243                      |
| Shares issued in connection with:                                     |              |        |                                  |                                                        |                      |                                 |
| Exercise of stock options                                             | 330          |        | 1,539                            |                                                        |                      | 1,539                           |
| Employee stock purchase plan                                          | 234          |        | 1,385                            |                                                        |                      | 1,385                           |
| Net income tax detriment from activity in employee stock<br>plans     |              |        | (471)                            |                                                        |                      | (471)                           |
| Equity-based compensation expense                                     |              |        | 4,030                            |                                                        |                      | 4,030                           |
| Net loss                                                              |              |        |                                  |                                                        | (21,975)             | (21,975)                        |
| Unrealized gain on securities held as available-for-sale              |              |        |                                  | 217                                                    |                      | 217                             |
| Deferred taxes on unrealized gain on available-for-sale<br>securities |              |        |                                  | (76)                                                   |                      | (76)                            |
| Foreign currency translation adjustment                               |              |        |                                  | 18                                                     |                      | 18                              |
| Comprehensive loss                                                    |              |        |                                  |                                                        |                      | (21,816)                        |

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|                              |        |    |    |    |         |    |     |    |        |    |         |
|------------------------------|--------|----|----|----|---------|----|-----|----|--------|----|---------|
| Balance at December 31, 2011 | 23,122 | \$ | 23 | \$ | 146,307 | \$ | 414 | \$ | 45,166 | \$ | 191,910 |
|------------------------------|--------|----|----|----|---------|----|-----|----|--------|----|---------|

See accompanying notes.

## INTEVAC, INC.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

|                                                                                                                         | Years Ended December 31, |            |             |
|-------------------------------------------------------------------------------------------------------------------------|--------------------------|------------|-------------|
|                                                                                                                         | 2011                     | 2010       | 2009        |
| <b>Operating activities</b>                                                                                             |                          |            |             |
| Net income (loss)                                                                                                       | \$ (21,975)              | \$ 28,049  | \$ (10,077) |
| Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by (used in) operating activities: |                          |            |             |
| Depreciation & amortization                                                                                             | 4,880                    | 5,307      | 5,031       |
| Net amortization (accretion) of investment premiums and discounts                                                       | 1,408                    |            | (20)        |
| Loss on sale of investments                                                                                             | 308                      |            |             |
| Gain on acquisition                                                                                                     |                          | (481)      |             |
| Amortization of intangible assets                                                                                       | 543                      | 554        | 554         |
| Equity-based compensation                                                                                               | 4,030                    | 3,316      | 4,255       |
| Deferred income taxes                                                                                                   | (7,140)                  | (2,142)    | (87)        |
| Excess tax benefits from equity-based compensation                                                                      |                          | (299)      | (69)        |
| Change in the fair value of acquisition-related contingent consideration                                                | 1,247                    | 108        |             |
| Loss(gain) on disposal of equipment                                                                                     | (78)                     | 153        | 57          |
| Changes in assets and liabilities:                                                                                      |                          |            |             |
| Accounts receivable                                                                                                     | 7,350                    | 18,845     | (28,935)    |
| Inventories                                                                                                             | 2,601                    | (1,555)    | (1,411)     |
| Prepaid expenses and other assets                                                                                       | 87                       | (2,665)    | (3,177)     |
| Accounts payable                                                                                                        | (705)                    | 450        | 441         |
| Accrued payroll and other accrued liabilities                                                                           | (9,008)                  | 9,987      | 6,902       |
| Customer advances                                                                                                       | 173                      | (8,313)    | 9,967       |
| Total adjustments                                                                                                       | 5,696                    | 23,265     | (6,492)     |
| Net cash and cash equivalents provided by (used in) operating activities                                                | (16,279)                 | 51,314     | (16,569)    |
| <b>Investing activities</b>                                                                                             |                          |            |             |
| Purchase of investments                                                                                                 | (111,940)                | (20,683)   | (26,979)    |
| Proceeds from sales and maturities of investments                                                                       | 47,039                   | 68,050     | 25,450      |
| Acquisition of SIT, net of cash acquired                                                                                |                          | (2,638)    |             |
| Proceeds from sale of equipment                                                                                         | 249                      |            |             |
| Purchase of equipment                                                                                                   | (5,582)                  | (7,055)    | (2,615)     |
| Net cash and cash equivalents provided by (used in) investing activities                                                | (70,234)                 | 37,674     | (4,144)     |
| <b>Financing activities</b>                                                                                             |                          |            |             |
| Proceeds from issuance of common stock                                                                                  | 2,924                    | 2,768      | 1,122       |
| Payment of acquisition-related contingent consideration                                                                 | (2,389)                  |            |             |
| Payment of notes payable assumed upon SIT acquisition                                                                   |                          | (177)      |             |
| Repayment of note payable                                                                                               |                          |            | (2,000)     |
| Excess tax benefits from equity-based compensation                                                                      |                          | 299        | 69          |
| Net cash and cash equivalents provided by (used in) financing activities                                                | 535                      | 2,890      | (809)       |
| Effect of exchange rate changes on cash                                                                                 | 18                       | 50         | (87)        |
| Net increase (decrease) in cash and cash equivalents                                                                    | (85,960)                 | 91,928     | (21,609)    |
| Cash and cash equivalents at beginning of period                                                                        | 109,520                  | 17,592     | 39,201      |
| Cash and cash equivalents at end of period                                                                              | \$ 23,560                | \$ 109,520 | \$ 17,592   |

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|                           |          |          |            |
|---------------------------|----------|----------|------------|
| Cash paid (received) for: |          |          |            |
| Income taxes              | \$ 336   | \$ 1,829 | \$ 713     |
| Income tax refund         | \$ (683) | \$ (481) | \$ (2,821) |

See accompanying notes.

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INTEVAC, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

**1. Summary of Significant Accounting Policies**

***Principles of Consolidation and Basis of Presentation***

The consolidated financial statements include the accounts of Intevac, Inc. and its subsidiaries (Intevac or the Company) after elimination of inter-company balances and transactions.

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

***Cash, Cash Equivalents and Investments***

Intevac considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents. Available-for-sale securities, comprised of commercial paper, FDIC insured corporate bonds, obligations of the U.S. government and its agencies, corporate debt securities, municipal bonds, variable rate demand notes ( VRDNs ) and Auction Rate Securities ( ARS ), are carried at fair value, with unrealized gains and losses recorded within other comprehensive income (loss) as a separate component of stockholders' equity. Realized gains and losses and declines in value judged to be other than temporary, if any, on available-for-sale securities are included in earnings. The cost of investment securities sold is determined by the specific identification method.

***Fair Value Measurement Definition and Hierarchy***

Intevac reports certain financial assets and liabilities at fair value. Intevac defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value measurements are classified and disclosed in one of the following three categories:

*Level 1* Valuations based on quoted prices in active markets for identical assets or liabilities.

*Level 2* Valuations based on other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* Valuations based on inputs that are generally unobservable and typically reflect management's estimates of assumptions that market participants would use in pricing the asset or liability.

***Business Combinations***

Intevac accounts for business combinations using the acquisition method of accounting. Transaction costs are expensed as incurred. In-process research and development ( IPR&D ) costs are capitalized as an intangible asset. Contingent consideration is recorded as a liability at the measurement date with subsequent re-measurements recorded as general and administrative expense. Costs for business restructuring and exit activities related to the acquired company are included in the post-combination financial results. During 2010, Intevac incurred \$255,000 of acquisition-related costs which have been included in selling, general and administrative expenses on the consolidated statements of operations.

***Trade Accounts and Notes Receivables and Doubtful Accounts***

Intevac evaluates the collectibility of trade accounts receivables and notes receivable on an ongoing basis and provides reserves against potential losses when appropriate. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, changes in customer payment tendencies and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Customer accounts are

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**INTEVAC, INC.**

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

written off against the allowance when the amount is deemed uncollectible. Also, accounts determined to be uncollectible are put in nonaccrual status whereby interest is not accrued on those accounts. Credit losses, when realized, have been within the range of the Company's expectations.

Included in trade receivables at December 31, 2011 is the current portion of a discounted promissory note from a customer of \$1.5 million. The non-current portion of the note receivable of \$3.0 million is included in other long-term assets.

Included in trade receivables are unbilled receivables related to government contracts of \$1.0 million and \$1.1 million at December 31, 2011 and December 31, 2010, respectively which includes \$387,000 and \$474,000 of fee retention, respectively.

***Inventories***

Inventories are generally stated at the lower of cost or market, with cost determined on an average cost basis.

***Property, Plant and Equipment***

Equipment and leasehold improvements are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows: computers and software, 3 years; machinery and equipment, 5 years; furniture, 7 years; vehicles, 4 years; and leasehold improvements, remaining lease term.

***Goodwill and Purchased Intangible Assets***

The purchase price of an acquired business is allocated, as applicable, between IPR&D, other identifiable intangible assets, net tangible assets and goodwill. IPR&D is defined as the value assigned to those projects for which the related products have no alternative future use. Determining the portion of the purchase price allocated to IPR&D and other intangible assets requires the Company to make significant estimates. The amount of the purchase price allocated to IPR&D and other intangible assets is determined by estimating the future cash flows of each project or technology and discounting the net cash flows back to their present values. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. For IPR&D, these valuation methodologies include consideration of the risk of the project not achieving commercial feasibility.

Contingent consideration is recorded at the acquisition date at the estimated fair value of the contingent payments. The acquisition date fair value is measured based on the consideration expected to be transferred (probability-weighted), discounted back to present value. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. The fair value of the contingent consideration is remeasured at the estimated fair value at each reporting period with the change in fair value recognized as income or expense in the consolidated statements of operations.

Goodwill represents the excess of the aggregate purchase price over the fair value of net assets, including IPR&D, of acquired businesses. Intevac's methodology for allocating the purchase price relating to purchase acquisitions is determined through established and generally accepted valuation techniques. Goodwill is measured as the excess of the cost of the acquisition over the sum of the amounts assigned to tangible and identifiable intangible assets acquired less liabilities assumed. Intevac assigns assets acquired (including goodwill) and liabilities assumed to a reporting unit as of the date of acquisition.

Purchased intangible assets other than goodwill are amortized over their useful lives unless these lives are determined to be indefinite. Purchased intangible assets are carried at cost, less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets, generally one to thirteen years using the straight line method.

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

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. For goodwill, Intevac performs a two-step impairment test. In the first step, Intevac compares the fair value of each reporting unit to its carrying value. Intevac's reporting units are consistent with the reportable segments identified in Note 12, based on the manner in which Intevac operates its business and the nature of those operations. Depending on the facts and circumstances Intevac determines the fair value of each of its reporting units based upon the most appropriate valuation technique using the income approach, the market approach or a combination thereof. The income and market approaches were selected as management believes these approaches generally provide the most reliable indications of fair value when the value of the operations is more dependent on the ability to generate earnings than on the value of the assets used in the production process. Under the income approach Intevac calculates the fair value of the reporting units based on the present value of estimated future cash flows. Under the market approach Intevac estimates the fair value based on market multiples of revenue or earnings for comparable companies. Each valuation technique has advantages and drawbacks, which must be considered when applying those techniques. The income approach closely correlates to management's expectations of future results but requires significant assumptions which can be highly sensitive. The market approach is relatively straightforward to measure, but it may be difficult to find directly comparable companies in the marketplace. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then Intevac would perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, Intevac would record an impairment loss equal to the difference. Intevac conducted these impairment tests in the fourth quarter of fiscal 2011, 2010 and 2009 and the results of these tests indicated that Intevac's goodwill and purchased intangible assets with indefinite useful lives were not impaired.

***Impairment of Long-Lived Assets***

Long-lived assets and certain identifiable intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability of long-lived assets is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value. No impairment charges were recognized in fiscal 2011, 2010 and 2009.

***Income Taxes***

Deferred tax assets and liabilities are recognized using enacted tax rates for the effect of temporary differences between book and tax bases of recorded assets and liabilities. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized.

On a quarterly basis, Intevac provides for income taxes based upon an annual effective income tax rate. The effective tax rate is highly dependent upon the level of Intevac's projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carryforwards, availability of tax credits and the effectiveness of Intevac's tax planning strategies. Intevac carefully monitors the changes in many factors and adjust its effective income tax rate on a timely basis. If actual results differ from the estimates, this could have a material effect on Intevac's business, financial condition and results of operations.

The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with Intevac's expectations could have a material effect on Intevac's business, financial condition and results of operations.

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**INTEVAC, INC.**

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

Intevac recognizes accrued interest and penalties related to unrecognized tax benefits in the provision for income taxes.

***Sales and Value Added Taxes***

Taxes collected from customers and remitted to governmental authorities are presented on a net basis in the accompanying consolidated statements of operations.

***Revenue Recognition***

In 2009, the FASB issued amended revenue recognition guidance for arrangements with multiple deliverables and certain software sold with tangible products. This new guidance eliminates the residual method of revenue recognition and requires the use of management's best estimate of selling price (ESP) for individual elements of an arrangement when vendor specific objective evidence (VSOE) or third party evidence (TPE) is unavailable. Intevac implemented this guidance prospectively beginning in the first quarter of fiscal 2010 for transactions that were initiated or materially modified during fiscal 2010. The implementation of the new guidance had an insignificant impact on reported net revenues as compared to net revenues under the previous guidance, as the new guidance did not change the units of accounting within sales arrangements, and the elimination of the residual method for the allocation of arrangement consideration had an inconsequential impact on the amount and timing of reported net revenues.

In 2010, the FASB issued guidance for the milestone method of revenue recognition. Under the milestone method, consideration earned from achievement of the milestone is viewed as being indicative of the value provided to the customer through either (1) the efforts performed or (2) a specific outcome resulting from the performance to achieve that specific milestone. Under the milestone method, contingent arrangement consideration earned from the achievement of a milestone is recognized in its entirety in the period in which the milestone is achieved. Under this new method of accounting, a milestone must be substantive before the method can be applied; that is, at the inception of the arrangement there is a substantial uncertainty about the achievement of the milestone, substantive effort is required to achieve the milestone, and none of the payment for the milestone is refundable. Intevac implemented this guidance prospectively beginning in the first quarter of fiscal 2010 for transactions that were initiated or materially modified during fiscal 2010. Implementation of this new guidance had an insignificant impact on reported net revenues as compared to net revenues under the previous guidance.

Intevac recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have passed to Intevac's customer or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Intevac's shipping terms are customarily FOB shipping point or equivalent terms. Intevac's revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment, Intevac recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer acceptance; and (3) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred until delivery of the deferred elements. When a sales arrangement contains multiple elements, Intevac allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its VSOE if available, TPE if VSOE is not available, or best ESP if neither VSOE nor TPE is available. Intevac generally utilizes the ESP due to the nature of its products. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements, usually split between delivery of the parts and installation on the customer's systems. In these cases, Intevac recognizes revenue for the relative sales price of the parts upon shipment and transfer of title, and recognizes revenue for the relative sales price of installation services when

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

those services are completed. Revenue related to sales of spare parts is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services. In addition, Intevac uses the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in management's judgment the degree of collectibility is uncertain.

Intevac performs research and development work under various government-sponsored research contracts. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. Intevac considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on fixed-price contracts is recognized on a milestone method or percentage-of-completion method of contract accounting. For contracts structured as milestone agreements, revenue is recognized when a specified milestone is achieved, provided that (1) the milestone event is substantive in nature and there is substantial uncertainty about the achievement of the milestone at the inception of the agreement, (2) the milestone payment is non-refundable, and (3) there is no continuing performance obligations associated with the milestone payment. Any milestone payments received prior to satisfying these revenue recognition criteria are deferred. Intevac generally determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected through completion of the contract. When estimates of total costs to be incurred on a contract exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

**Advertising Costs**

Advertising costs are expensed as incurred. Advertising costs were not material for all periods presented.

**Foreign Currency Translation**

The functional currency of Intevac's foreign subsidiaries in Singapore and Hong Kong and the Taiwan branch is the U.S. dollar. The functional currency of Intevac's foreign subsidiaries in China, Malaysia and Korea is the local currency of the country in which the respective subsidiary operates. Assets and liabilities recorded in foreign currencies are translated at year-end exchange rates; revenues and expenses are translated at average exchange rates during the year. The effect of foreign currency translation adjustments are included in stockholders' equity as a component of accumulated other comprehensive income in the accompanying consolidated balance sheets. The effects of foreign currency transactions are included in other income in the determination of net income. Net losses from foreign currency transactions were \$32,000, \$520,000 and \$226,000 in 2011, 2010 and 2009, respectively.

**Comprehensive Income**

The components of accumulated other comprehensive income (loss), were as follows at December 31, 2011 and 2010:

|                                                                                       | December 31,   |          |
|---------------------------------------------------------------------------------------|----------------|----------|
|                                                                                       | 2011           | 2010     |
|                                                                                       | (In thousands) |          |
| Accumulated net unrealized holding loss on available-for-sale investments, net of tax | \$ (267)       | \$ (408) |
| Foreign currency translation gains and losses                                         | 681            | 663      |
| Total accumulated other comprehensive income                                          | \$ 414         | \$ 255   |

**Employee Stock Plans**

Intevac has equity-based compensation plans that provide for the grant to employees of equity-based awards, including incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. In addition, these plans provide for the grant of non-statutory stock



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**INTEVAC, INC.**

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

options to non-employee directors and consultants. Intevac also has an employee stock purchase plan, which provides Intevac's employees with the opportunity to purchase Intevac common stock at a discount through payroll deductions. See Note 2 for a complete description of these plans and their accounting treatment.

**Recent Accounting Pronouncements**

In September 2011, the Financial Accounting Standards Board ( FASB ) issued authoritative guidance that allows entities to first assess qualitatively whether it is necessary to perform the two-step goodwill impairment test. If an entity believes, as a result of its qualitative assessment, that it is more likely than not that the fair value of a reporting unit is less than its carrying amount, the quantitative two-step goodwill impairment test is required. An entity has the unconditional option to bypass the qualitative assessment and proceed directly to performing the first step of the goodwill impairment test. The guidance is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011, with early adoption permitted. Intevac does not expect the adoption of these provisions to have a significant effect on its consolidated financial statements.

In June 2011, the FASB issued authoritative guidance that amends the presentation requirements for comprehensive income in financial statements. The guidance requires entities to report components of comprehensive income either as part of a single continuous statement of comprehensive income that would combine the components of net income and other comprehensive income, or in a separate, but consecutive, statement following the statement of income. The guidance is effective for interim and annual periods beginning after December 15, 2011 and is to be applied retrospectively. Intevac does not expect the adoption of these provisions to have a significant effect on its consolidated financial statements.

In May 2011, the FASB issued authoritative guidance that amends the existing requirements for fair value measurement and disclosure. The guidance expands the disclosure requirements around fair value measurements categorized in Level 3 of the fair value hierarchy and requires disclosure of the level in the fair value hierarchy of items that are not measured at fair value in the statement of financial position but whose fair value must be disclosed. It also clarifies and expands upon existing requirements for measurement of the fair value of financial assets and liabilities as well as instruments classified in stockholders' equity. The guidance is effective for interim and annual periods beginning after December 15, 2011. Intevac does not expect the adoption of these provisions to have a significant effect on its consolidated financial statements.

**2. Equity-Based Compensation**

Intevac accounts for share-based awards in accordance with the provisions of the accounting guidance which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees, consultants and directors based upon the grant-date fair value of those awards. The estimated fair value of Intevac's equity-based awards, less expected forfeitures, is amortized over the awards' service periods using the graded vesting attribution method. During the years ended December 31, 2011, 2010 and 2009 Intevac recognized equity-based compensation expense related to stock options and shares issued pursuant to its employee stock purchase plan of \$4.0 million, \$3.3 million and \$4.3 million, respectively.

**Descriptions of Plans**

*2004 Equity Incentive Plan*

In 2004, the Board of Directors and Intevac stockholders approved adoption of the 2004 Equity Incentive Plan (the 2004 Plan ). The 2004 Plan serves as the successor equity incentive program to the 1995 Stock Option/Stock Issuance Plan (the 1995 Plan ). Upon adoption of the 2004 Plan, all remaining shares available for issuance under the 1995 Plan were transferred to the 2004 Plan.

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The 2004 Plan is a broad-based, long-term retention program intended to attract and retain qualified management and employees, and align stockholder and employee interests. The 2004 Plan permits the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. As of December 31, 2011, only stock options have been issued pursuant to the 2004 Plan. Option price, vesting period, and other terms are determined by the administrator of the 2004 Plan, but the option price shall generally not be less than 100% of the fair market value per share on the date of grant. As of December 31, 2011, 4.1 million shares of common stock were authorized for future issuance under the 2004 Plan. Options granted under the 2004 Plan are exercisable upon vesting and vest over periods of up to five years. Options currently expire no later than ten years from the date of grant. The 2004 Plan expires no later than March 10, 2014.

During the year ended December 31, 2011, Intevac granted 583,000 stock options pursuant to the 2004 Plan with an estimated total grant-date fair value of \$3.5 million including 2,000 shares granted to a consultant with a grant date fair value of \$11,000. Of this amount, Intevac estimated that the equity-based compensation for option grants that will be forfeited, and are therefore not expected to vest, was \$813,000. During the year ended December 31, 2010, Intevac granted 763,000 stock options pursuant to the 2004 Plan with an estimated total grant-date fair value of \$5.1 million including 2,000 shares granted to a consultant with a grant date fair value of \$13,000. Of this amount, Intevac estimated that the equity-based compensation for option grants that will be forfeited, and are therefore not expected to vest, was \$1.2 million. During the year ended December 31, 2009, Intevac granted 536,000 stock options pursuant to the 2004 Plan with an estimated total grant-date fair value of \$1.4 million. Of this amount, Intevac estimated that the equity-based compensation for option grants that will be forfeited, and are therefore not expected to vest, was \$319,000.

*2003 Employee Stock Purchase Plan*

In 2003, Intevac's stockholders approved adoption of the 2003 Employee Stock Purchase Plan (the ESPP), which serves as the successor to the Employee Stock Purchase Plan originally adopted in 1995. Upon adoption of the ESPP, all shares available for issuance under the prior plan were transferred to the ESPP. The ESPP provides that eligible employees may purchase Intevac 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 10% of their base earnings withheld to purchase Intevac common stock. Under the ESPP, Intevac sold 234,000, 255,000 and 240,000 shares to employees in 2011, 2010 and 2009, respectively. As of December 31, 2011, 302,000 shares remained available for issuance under the ESPP. During the years ended December 31, 2011, 2010, and 2009 Intevac granted purchase rights with an estimated total grant-date fair value of \$1.8 million, \$53,000 and \$328,000, respectively.

The effect of recording equity-based compensation for the years ended December 31, 2011, 2010 and 2009 was as follows (in thousands):

|                                             | 2011     | 2010     | 2009     |
|---------------------------------------------|----------|----------|----------|
| Equity-based compensation by type of award: |          |          |          |
| Stock options                               | \$ 2,924 | \$ 2,965 | \$ 3,468 |
| Employee stock purchase plan                | 1,106    | 351      | 787      |
| Total equity-based compensation             | 4,030    | 3,316    | 4,255    |
| Tax effect on equity-based compensation     | (1,030)  | (1,068)  | (1,224)  |
| Net effect on net income                    | \$ 3,000 | \$ 2,248 | \$ 3,031 |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Stock Options*

The exercise price of each stock option equals the market price of Intevac's stock on the date of grant. Most options are scheduled to vest over four years and expire no later than ten years after the grant date. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. This model was developed for use in estimating the value of publicly traded options that have no vesting restrictions and are fully transferable. Intevac's employee stock options have characteristics significantly different from those of publicly traded options. The weighted average assumptions used in the model are outlined in the following table:

|                                     | 2011   | 2010   | 2009   |
|-------------------------------------|--------|--------|--------|
| Stock Options:                      |        |        |        |
| Expected volatility                 | 64.82% | 67.75% | 67.17% |
| Risk free interest rate             | 1.71%  | 1.69%  | 2.01%  |
| Expected term of options (in years) | 4.75   | 4.52   | 4.47   |
| Dividend yield                      | None   | None   | None   |

The computation of the expected volatility assumption used in the Black-Scholes calculations for new grants is based on historical volatility of Intevac's stock price. The risk-free interest rate is based on the yield available on U.S. Treasury Strips with an equivalent remaining term. The expected life 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 stock-based awards and vesting schedules. The dividend yield assumption is based on Intevac's history of not paying dividends and the assumption of not paying dividends in the future.

The weighted-average estimated fair value of employee stock options granted during the years ended December 31, 2011, 2010 and 2009 was \$5.98, \$6.63 and \$2.57 per share, respectively.

*ESPP*

The fair value of the employee stock purchase right is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

|                                             | 2011   | 2010   | 2009   |
|---------------------------------------------|--------|--------|--------|
| Stock Purchase Rights:                      |        |        |        |
| Expected volatility                         | 51.63% | 55.20% | 82.56% |
| Risk free interest rate                     | 0.44%  | 0.41%  | 0.85%  |
| Expected term of purchase rights (in years) | 1.36   | 0.73   | 1.85   |
| Dividend yield                              | None   | None   | None   |

The expected life of purchase rights is the period of time remaining in the current offering period. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the ESPP during the years ended December 31, 2011, 2010 and 2009 was \$4.84, \$4.63 and \$2.73 per share, respectively.

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Stock Plan Activity**2004 Equity Incentive Plan*

A summary of activity under the above captioned plan is as follows:

|                                                  | Shares    | Weighted Average<br>Exercise Price | Weighted<br>Average<br>Remaining<br>Contractual Term<br>(years) | Aggregate<br>Intrinsic<br>Value |
|--------------------------------------------------|-----------|------------------------------------|-----------------------------------------------------------------|---------------------------------|
| Options outstanding at December 31, 2010         | 3,385,245 | \$ 11.61                           | 5.93                                                            | \$ 12,104,861                   |
| Options granted                                  | 582,700   | \$ 11.18                           |                                                                 |                                 |
| Options forfeited                                | (246,224) | \$ 14.10                           |                                                                 |                                 |
| Options exercised                                | (329,796) | \$ 4.67                            |                                                                 |                                 |
| Options outstanding at December 31, 2011         | 3,391,925 | \$ 12.03                           | 5.53                                                            | \$ 1,384,535                    |
| Vested and expected to vest at December 31, 2011 | 3,208,532 | \$ 12.08                           | 5.49                                                            | \$ 1,343,613                    |
| Options exercisable at December 31, 2011         | 2,070,068 | \$ 12.89                           | 5.05                                                            | \$ 807,932                      |

The total intrinsic value of options exercised during fiscal years 2011, 2010 and 2009 was \$1.9 million, \$1.3 million and \$149,000, respectively. At December 31, 2011, Intevac had \$3.0 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock option plans that will be recognized over the weighted average period of 1.38 years.

The options outstanding and currently exercisable at December 31, 2011 were in the following exercise price ranges:

| Range of Exercise Prices | Options Outstanding                |                                                                       |                                       | Options Exercisable                 |                                       |
|--------------------------|------------------------------------|-----------------------------------------------------------------------|---------------------------------------|-------------------------------------|---------------------------------------|
|                          | Number of<br>Shares<br>Outstanding | Weighted<br>Average<br>Remaining<br>Contractual<br>Term<br>(In Years) | Weighted Average<br>Exercise<br>Price | Number<br>Vested and<br>Exercisable | Weighted Average<br>Exercise<br>Price |
| \$ 2.63 - \$ 6.73        | 453,961                            | 6.03                                                                  | \$ 4.35                               | 286,359                             | \$ 4.58                               |
| \$ 6.88 - \$10.69        | 441,690                            | 4.24                                                                  | \$ 8.65                               | 314,565                             | \$ 8.47                               |
| \$10.86 - \$11.25        | 346,699                            | 6.53                                                                  | \$ 11.15                              | 260,243                             | \$ 11.15                              |
| \$11.33 - \$11.33        | 493,050                            | 6.38                                                                  | \$ 11.33                              |                                     | \$                                    |
| \$11.66 - \$11.86        | 426,400                            | 5.41                                                                  | \$ 11.84                              | 142,776                             | \$ 11.84                              |
| \$12.00 - \$15.98        | 382,575                            | 5.25                                                                  | \$ 13.79                              | 263,200                             | \$ 13.84                              |
| \$16.13 - \$16.13        | 480,550                            | 5.16                                                                  | \$ 16.13                              | 480,550                             | \$ 16.13                              |
| \$16.49 - \$29.45        | 367,000                            | 5.27                                                                  | \$ 20.34                              | 322,375                             | \$ 20.88                              |
| \$ 2.63 - \$29.45        | 3,391,925                          | 5.53                                                                  | \$ 12.03                              | 2,070,068                           | \$ 12.89                              |

*2003 Employee Stock Purchase Plan*

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During fiscal years 2011, 2010 and 2009 the aggregate intrinsic value of purchase rights exercised under the ESPP was \$1.4 million, \$2.2 million and \$1.0 million, respectively, determined as of the date of purchase. During fiscal years 2011, 2010 and 2009, 234,000, 255,000 and 240,000 shares were purchased at an average per share price of \$5.92, \$4.02 and \$3.73. At December 31, 2011, there were 302,000 shares available to be issued under the ESPP. As of December 31, 2011, Intevac had \$706,000 of total unrecognized compensation expense, net of estimated forfeitures related to purchase rights that will be recognized over the weighted average period of 0.7 years.

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**3. Earnings Per Share**

Intevac calculates basic earnings per share ( EPS ) using net income (loss) and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuance of common stock pursuant to the exercise of employee stock options.

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

|                                                       | 2011                                     | 2010      | 2009        |
|-------------------------------------------------------|------------------------------------------|-----------|-------------|
|                                                       | (In thousands, except per share amounts) |           |             |
| Net income (loss)                                     | \$ (21,975)                              | \$ 28,049 | \$ (10,077) |
| Weighted-average shares basic                         | 22,903                                   | 22,340    | 21,975      |
| Effect of dilutive potential common shares            |                                          | 637       |             |
| Weighted-average shares diluted                       | 22,903                                   | 22,977    | 21,975      |
| Net income (loss) per share basic                     | \$ (0.96)                                | \$ 1.26   | \$ (0.46)   |
| Net income (loss) per share diluted                   | \$ (0.96)                                | \$ 1.22   | \$ (0.46)   |
| Antidilutive shares based on employee awards excluded | 2,699                                    | 1,896     | 3,150       |

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

**4. Concentrations***Credit Risk and Significant Customers*

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist of cash equivalents, short- and long-term investments, and accounts and notes receivable. Intevac generally invests its excess cash in money market funds, commercial paper, FDIC insured corporate bonds, obligations of the U.S. government and its agencies, corporate debt securities, municipal bonds, VRDNs and ARS. 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.

Intevac's accounts receivable tend to be concentrated in a limited number of customers. At December 31, 2011, one customer accounted for 37% of Intevac's accounts receivable. At December 31, 2010, three customers accounted for 29%, 24% and 10%, respectively, of Intevac's accounts receivable and in aggregate accounted for 63% of accounts receivable.

Intevac's largest customers tend to change from period to period. Historically, a significant portion of Intevac's revenues in any particular period have been attributable to sales to a limited number of customers. In 2011, two customers accounted for 41% and 12%, respectively, of consolidated net revenues and in aggregate accounted for 53% of net revenues. In 2010, three customers accounted for 40%, 26% and 12%, respectively, of consolidated net revenues and in aggregate accounted for 78% of net revenues. In 2009, two customers accounted for 38% and 17%, respectively, of consolidated net revenues and in aggregate accounted for 55% of net revenues. Intevac performs credit evaluations of its customers' financial condition and generally requires deposits on system orders but does not generally require collateral or other security to support customer receivables.

*Products*

Disk manufacturing products contributed a significant portion of Intevac's revenues in 2011, 2010, and 2009. Intevac expects that the ability to maintain or expand its current levels of revenues in the future will depend upon continuing market demand for its products; its success in enhancing its existing systems and

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

developing and manufacturing competitive disk manufacturing equipment, such as the 200 Lean; Intevac's success in developing both military and commercial products based on its low-light technology; and its success in utilizing Intevac's expertise in complex manufacturing equipment to develop and sell new equipment products for photovoltaic ( PV ) manufacturing.

**5. Balance Sheet Details**

Balance sheet details were as follows as of December 31, 2011 and 2010:

*Inventories*

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

|                  | December 31,   |           |
|------------------|----------------|-----------|
|                  | 2011           | 2010      |
|                  | (in thousands) |           |
| Raw materials    | \$ 12,662      | \$ 13,370 |
| Work-in-progress | 3,020          | 5,295     |
| Finished goods   | 2,388          | 2,006     |
|                  | \$ 18,070      | \$ 20,671 |

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

*Property, Plant and Equipment*

|                                                | December 31,   |           |
|------------------------------------------------|----------------|-----------|
|                                                | 2011           | 2010      |
|                                                | (in thousands) |           |
| Leasehold improvements                         | \$ 14,936      | \$ 14,043 |
| Machinery and equipment                        | 40,469         | 36,936    |
|                                                | 55,405         | 50,979    |
| Less accumulated depreciation and amortization | 40,956         | 37,061    |
| Total property, plant and equipment, net       | \$ 14,449      | \$ 13,918 |

*Customer Advances*

Customer advances generally represent nonrefundable deposits invoiced by the Company in connection with receiving customer purchase orders and other events preceding acceptance of systems. Customer advances related to products that have not been shipped to customers and included in accounts receivable were \$1.9 million at December 31, 2011 and \$1.3 million at December 31, 2010.

*Other Accrued Liabilities*

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|                                              | December 31,    |                  |
|----------------------------------------------|-----------------|------------------|
|                                              | 2011            | 2010             |
|                                              | (in thousands)  |                  |
| Acquisition-related contingent consideration | \$ 3,942        | \$ 4,234         |
| Accrued product warranties                   | 2,586           | 2,612            |
| Deferred revenue                             | 1,665           | 1,714            |
| Other taxes payable                          | 714             | 991              |
| Accrued income taxes                         | 183             | 360              |
| Other                                        | 797             | 1,193            |
| <b>Total other accrued liabilities</b>       | <b>\$ 9,887</b> | <b>\$ 11,104</b> |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Other Long-Term Liabilities*

|                                              | December 31,<br>2011      2010<br>(in thousands) |                  |
|----------------------------------------------|--------------------------------------------------|------------------|
| Acquisition-related contingent consideration | \$ 4,773                                         | \$ 5,623         |
| Accrued income taxes                         | 4,191                                            | 4,098            |
| Deferred profit                              | 820                                              | 1,106            |
| Accrued product warranties                   | 138                                              | 803              |
| <b>Total other long-term liabilities</b>     | <b>\$ 9,922</b>                                  | <b>\$ 11,630</b> |

**6. Goodwill and Purchased Intangible Assets, Net**

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. Intevac conducted these impairment tests in the fourth quarter of fiscal 2011, 2010 and 2009 and the results of these tests indicated that Intevac's goodwill and purchased intangible assets with indefinite useful lives were not impaired.

Information regarding goodwill by reportable segment for the years ended December 31, 2011 and 2010 is as follows:

|                                     | December 31, 2011 |                      |           | December 31, 2010 |                      |           |
|-------------------------------------|-------------------|----------------------|-----------|-------------------|----------------------|-----------|
|                                     | Equipment         | Intevac<br>Photonics | Total     | Equipment         | Intevac<br>Photonics | Total     |
|                                     | (in thousands)    |                      |           |                   |                      |           |
| Beginning balance                   | \$ 10,484         | \$ 7,905             | \$ 18,389 | \$ 10,484         | \$ 7,905             | \$ 18,389 |
| Goodwill acquired during the period |                   |                      |           | 10,484            |                      | 10,484    |
| Impairment charges                  |                   |                      |           |                   |                      |           |
| Ending balance                      | \$ 10,484         | \$ 7,905             | \$ 18,389 | \$ 10,484         | \$ 7,905             | \$ 18,389 |

During the year ended December 31, 2010, goodwill increased by \$10.5 million due to the acquisition of Solar Implant Technologies, Inc. (SIT).

Information regarding other acquisition-related intangible assets is as follows:

|                          | December 31, 2011           |                             |                           | December 31, 2010           |                             |                           |
|--------------------------|-----------------------------|-----------------------------|---------------------------|-----------------------------|-----------------------------|---------------------------|
|                          | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Carrying<br>Amount |
|                          | (in thousands)              |                             |                           |                             |                             |                           |
| Customer relationships   | \$ 3,181                    | \$ 1,472                    | \$ 1,709                  | \$ 3,181                    | \$ 1,074                    | \$ 2,107                  |
| Purchased technology     | 1,145                       | 533                         | 612                       | 1,145                       | 388                         | 757                       |
| Covenants not to compete | 140                         | 140                         |                           | 140                         | 140                         |                           |
| Backlog                  | 199                         | 199                         |                           | 199                         | 199                         |                           |

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|                                     |          |          |          |          |          |          |
|-------------------------------------|----------|----------|----------|----------|----------|----------|
| Total amortizable intangible assets | 4,665    | 2,344    | 2,321    | 4,665    | 1,801    | 2,864    |
| IPR&D                               | 4,000    |          | 4,000    | 4,000    |          | 4,000    |
| Tradename                           | 120      |          | 120      | 120      |          | 120      |
| Total intangible assets             | \$ 8,785 | \$ 2,344 | \$ 6,441 | \$ 8,785 | \$ 1,801 | \$ 6,984 |

Total amortization expense of purchased intangibles for the years ended December 31, 2011, 2010 and 2009 was \$543,000, \$554,000 and \$554,000 respectively. Future amortization expense is expected to be \$541,000 for 2012, \$541,000 for 2013, \$363,000 for 2014, \$284,000 for 2015, \$281,000 for 2016 and \$311,000 thereafter. Intangible assets by segment as of December 31, 2011 are as follows: Equipment; \$5.6 million and Intevac Photonics; \$866,000.

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**7. Business Combination**

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

In connection with the acquisition of SIT, Intevac agreed to pay up to an aggregate of \$7.0 million in cash to the selling shareholders if certain milestones are achieved over a specified period. Intevac estimated the fair value of this contingent consideration to be in the amount of \$5.6 million based on the probability that certain milestones would be met and the payments would be made on the targeted dates outlined in the acquisition agreement. On July 21, 2011, Intevac made \$2.4 million in payments to the selling shareholders for achievement of the first milestone.

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

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 consolidated statement of operations. The following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the years ended December 31, 2011 and 2010:

|                                                     | 2011           | 2010     |
|-----------------------------------------------------|----------------|----------|
|                                                     | (In thousands) |          |
| Beginning balance                                   | \$ 9,857       | \$       |
| Contingent consideration acquired during the period |                | 9,749    |
| Changes in fair value                               | 1,247          | 108      |
| Cash payment made                                   | (2,389)        |          |
| Ending balance                                      | \$ 8,715       | \$ 9,857 |

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

Intevac has accounted for the acquisition of SIT as a business combination. Under business combination accounting, the assets and liabilities of SIT were recorded as of the acquisition date, at their respective fair values, and consolidated with the Company. The preliminary purchase price allocation is based on estimates of

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

the fair value of assets acquired and liabilities assumed. Subsequent to the acquisition, Intevac paid in full \$177,000 in notes payable to certain selling shareholders assumed upon the acquisition. The purchase price has been allocated as follows:

(in thousands)

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

Intevac's consolidated financial statements include SIT's operating results from the date of acquisition, November 19, 2010. The pro forma impact of the above acquisition was not significant to Intevac's results for the year ended December 31, 2010.

## 8. Financial Instruments

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

|                                       | Amortized<br>Cost | December 31, 2011              |                                 | Fair<br>Value |
|---------------------------------------|-------------------|--------------------------------|---------------------------------|---------------|
|                                       |                   | Unrealized<br>Holding<br>Gains | Unrealized<br>Holding<br>Losses |               |
| (In thousands)                        |                   |                                |                                 |               |
| Cash and cash equivalents:            |                   |                                |                                 |               |
| Cash                                  | \$ 14,268         | \$                             | \$                              | \$ 14,268     |
| Money market funds                    | 4,845             |                                |                                 | 4,845         |
| Commercial paper                      | 4,447             |                                |                                 | 4,447         |
| <br>                                  |                   |                                |                                 |               |
| Total cash and cash equivalents       | \$ 23,560         | \$                             | \$                              | \$ 23,560     |
| Short-term investments:               |                   |                                |                                 |               |
| 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         |
| <br>                                  |                   |                                |                                 |               |
| Total short-term investments          | \$ 58,546         | \$ 117                         | \$ 78                           | \$ 58,585     |
| Long-term investments:                |                   |                                |                                 |               |

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|                                               |            |        |        |            |
|-----------------------------------------------|------------|--------|--------|------------|
| 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      |
| Total long-term investments                   | \$ 33,127  | \$ 38  | \$ 488 | \$ 32,677  |
| Total cash, cash equivalents, and investments | \$ 115,233 | \$ 155 | \$ 566 | \$ 114,822 |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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

The contractual maturities of available-for-sale securities at December 31, 2011 are presented in the following table.

|                                    | Amortized<br>Cost | Fair<br>Value     |
|------------------------------------|-------------------|-------------------|
|                                    | (In thousands)    |                   |
| Due in one year or less            | \$ 63,402         | \$ 63,439         |
| Due after one through two years(1) | 28,803            | 28,762            |
| Due after ten years(2)             | 8,760             | 8,353             |
|                                    | <b>\$ 100,965</b> | <b>\$ 100,554</b> |

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

(2) Includes \$1.8 million in par value of VRDNs and \$4.9 million in par value of ARS.

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 December 31, 2011.

|                                       | December 31, 2011                           |                     |                                                |                     |
|---------------------------------------|---------------------------------------------|---------------------|------------------------------------------------|---------------------|
|                                       | In Loss Position for<br>Less than 12 Months |                     | In Loss Position for<br>Greater than 12 Months |                     |
|                                       | Fair Value                                  | Gross<br>Unrealized | Fair Value                                     | Gross<br>Unrealized |
|                                       |                                             | Losses              |                                                | Losses              |
| (In thousands)                        |                                             |                     |                                                |                     |
| Corporate bonds and medium-term notes | \$ 21,366                                   | \$ 155              | \$                                             | \$                  |
| U.S. treasury and agency securities   | 2,497                                       | 1                   |                                                |                     |
| ARS                                   |                                             |                     | 4,490                                          | 410                 |
|                                       | \$ 23,863                                   | \$ 156              | \$ 4,490                                       | \$ 410              |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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.

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

As of December 31, 2011, all of the Company's Level 3 financial instruments consisted of ARS with an aggregate par value of \$4.9 million that failed at auction. There was insufficient observable market information to determine fair value for these financial instruments. The Company estimated the fair values for these securities 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. As a result of this review, the Company determined its ARS to have a temporary impairment of \$410,000 as of December 31, 2011. 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. Failed ARS represent approximately 3.9% of the Company's total cash, cash equivalents and investments as of December 31, 2011. During 2011, Intevac participated in three tender offers, sold ARS with par values of \$5.5 million, collected \$5.2 million and recognized realized losses on the sales of \$308,000. On July 27, 2010, as a result of a favorable ruling from the Financial Industry Regulatory Authority arbitration panel, Intevac received \$54.8 million from the repurchase of by Citigroup of previously held ARS at par including interest.

The following table represents the fair value hierarchy of Intevac's assets measured at fair value on a recurring basis as of December 31, 2011.

|                                       | Fair Value Measurements at December 31, 2011 |           |           |          |
|---------------------------------------|----------------------------------------------|-----------|-----------|----------|
|                                       | Total                                        | Level 1   | Level 2   | Level 3  |
|                                       | (In thousands)                               |           |           |          |
| Assets:                               |                                              |           |           |          |
| Money market funds                    | \$ 4,845                                     | \$ 4,845  | \$        | \$       |
| U.S. treasury and agency securities   | 27,530                                       | 10,730    | 16,800    |          |
| FDIC insured corporate bonds          | 9,619                                        |           | 9,619     |          |
| Commercial paper                      | 5,497                                        |           | 5,497     |          |
| Corporate bonds and medium-term notes | 41,315                                       |           | 41,315    |          |
| Municipal bonds                       | 4,908                                        |           | 4,908     |          |
| VRDNs                                 | 2,350                                        |           | 2,350     |          |
| ARS                                   | 4,490                                        |           |           | 4,490    |
| Total assets                          | \$ 100,554                                   | \$ 15,575 | \$ 80,489 | \$ 4,490 |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table presents the changes in Level 3 instruments measured on a recurring basis for the years ended December 31, 2011, 2010 and 2009. These balances consist of ARS classified as available-for-sale with changes in fair value recorded in stockholders' equity.

|                                                             | 2011      | 2010<br>(in thousands) | 2009      |
|-------------------------------------------------------------|-----------|------------------------|-----------|
| Beginning balance                                           | \$ 10,273 | \$ 66,249              | \$ 66,328 |
| Net realized losses                                         | (308)     |                        |           |
| Net unrealized gains included in other comprehensive income | 217       | 3,074                  | 4,371     |
| Proceeds from tender offers                                 | (5,192)   |                        |           |
| Redemptions at par                                          | (500)     | (59,050)               | (4,450)   |
| Ending balance                                              | \$ 4,490  | \$ 10,273              | \$ 66,249 |

Included in accounts payable is \$714,000 and \$660,000 of book overdraft at December 31, 2011 and 2010, respectively.

### 9. Income Taxes

The provision for (benefit from) income taxes on income (loss) from continuing operations consists of the following (in thousands):

|          | Years Ended December 31, |          |            |
|----------|--------------------------|----------|------------|
|          | 2011                     | 2010     | 2009       |
| Federal: |                          |          |            |
| Current  | \$ (899)                 | \$ 5,241 | \$ (3,927) |
| Deferred | (3,633)                  | (1,706)  | (3,860)    |
|          | (4,532)                  | 3,535    | (7,787)    |
| State:   |                          |          |            |
| Current  | 8                        | 8        | 3          |
| Deferred |                          |          | 1,567      |
|          | 8                        | 8        | 1,570      |
| Foreign: |                          |          |            |
| Current  | 141                      | 419      | 201        |
| Deferred | (3,748)                  |          |            |
|          | (3,607)                  | 419      | 201        |
| Total    | \$ (8,131)               | \$ 3,962 | \$ (6,016) |

Income (loss) before income taxes (benefit) consisted of the following (in thousands):

|         | Years Ended December 31, |        |             |
|---------|--------------------------|--------|-------------|
|         | 2011                     | 2010   | 2009        |
| U.S     | \$ (15,078)              | \$ 384 | \$ (22,513) |
| Foreign | (15,028)                 | 31,627 | 6,420       |

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|                    | \$ (30,106) | \$ 32,011 | \$ (16,093) |
|--------------------|-------------|-----------|-------------|
| Effective tax rate | 27.0%       | 12.4%     | 37.4%       |

The tax benefits associated with exercises of nonqualified stock options and disqualifying dispositions of stock acquired through incentive stock options and the employee stock purchase plan increased income taxes receivable by \$299,000 and \$69,000, in 2010 and 2009 respectively. Such benefits were credited to additional paid-in capital.

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. Significant components of deferred tax assets are as follows (in thousands):

|                                                                 | December 31, |           |
|-----------------------------------------------------------------|--------------|-----------|
|                                                                 | 2011         | 2010      |
| Deferred tax assets:                                            |              |           |
| Vacation, rent, warranty and other accruals                     | \$ 1,191     | \$ 1,073  |
| Depreciation and amortization                                   | 2,426        | 3,416     |
| Inventory valuation                                             | 1,163        | 2,029     |
| Deferred income                                                 | 209          | 308       |
| Equity-based compensation                                       | 6,655        | 6,156     |
| Net operating loss, research and other tax credit carryforwards | 27,097       | 16,949    |
| Impairment losses on available-for-sale securities              | 145          | 221       |
| Other                                                           | 118          | (211)     |
|                                                                 | 39,004       | 29,941    |
| Valuation allowance for deferred tax assets                     | (13,561)     | (10,699)  |
| Total deferred tax assets                                       | 25,443       | 19,242    |
| Deferred tax liabilities:                                       |              |           |
| Purchased technology                                            | (1,524)      | (1,524)   |
| Net deferred tax assets                                         | \$ 23,919    | \$ 17,718 |
| As reported on the balance sheet:                               |              |           |
| Current assets                                                  |              |           |
| Deferred tax assets                                             | \$ 2,457     | \$ 3,400  |
| Valuation allowance for deferred tax assets                     | (255)        | (276)     |
| Net current deferred tax assets                                 | 2,202        | 3,124     |
| Other long-term assets                                          |              |           |
| Deferred tax assets                                             | 35,023       | 25,017    |
| Valuation allowance for deferred tax assets                     | (13,306)     | (10,423)  |
| Net non-current deferred tax assets                             | 21,717       | 14,594    |
| Net deferred tax assets                                         | \$ 23,919    | \$ 17,718 |

The valuation allowance of \$13.6 million is attributable to state income tax temporary differences and deferred research and other tax credits that are not realizable in the foreseeable future. State research credit carry-forwards of \$8.9 million, which are fully offset by a valuation allowance, do not expire.

The difference between the tax provision (benefit) at the statutory federal income tax rate and the tax provision (benefit) was as follows (in thousands):

Years Ended December 31,

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|                                                                                      | 2011        | 2010      | 2009       |
|--------------------------------------------------------------------------------------|-------------|-----------|------------|
| Income tax (benefit) at the federal statutory rate                                   | \$ (10,537) | \$ 11,204 | \$ (5,632) |
| State income taxes, net of federal benefit                                           | 5           | 5         | 1,020      |
| Effect of foreign operations taxes at various rates                                  | 1,653       | (10,650)  | (2,046)    |
| Research tax credits                                                                 | (1,200)     | (500)     | (565)      |
| Effect of tax rate changes, permanent differences and adjustments of prior deferrals | 960         | 187       | 965        |
| Unrecognized tax benefits                                                            | 988         | 3,716     | 242        |
| Total                                                                                | \$ (8,131)  | \$ 3,962  | \$ (6,016) |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Included in the above rate reconciliation for the year ended December 31, 2009 is \$600,000 of net unfavorable federal adjustments related to prior estimates for research tax credits and the Domestic Production Activities Deduction.

Intevac has not provided for U.S. federal income and foreign withholding taxes on approximately \$33.6 million of undistributed earnings from non-U.S. operations as of December 31, 2011 because Intevac intends to reinvest such earnings indefinitely outside of the United States. If Intevac were to distribute these earnings, foreign tax credits may become available under current law to reduce the resulting U.S. income tax liability. Determination of the amount of unrecognized deferred tax liability related to these earnings is not practicable. Intevac will remit the non-indefinitely reinvested earnings, if any, of Intevac's non-U.S. subsidiaries where excess cash has accumulated and Intevac determines that it is advantageous for business operations, tax or cash reasons.

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. As a result of this incentive, the impact of the tax holiday decreased income taxes by \$1.2 million, \$5.1 million and \$1.2 million in 2011, 2010 and 2009, respectively. The benefit of the tax holiday on net income (loss) per share (diluted) was approximately \$0.05, \$0.22, and \$0.06 in 2011, 2010 and 2009, respectively.

Included in prepaid expenses and other current assets at both December 31, 2011 and 2010 is \$5.7 million and \$4.4 million, respectively, of Federal income taxes receivable which represents amounts available as a result of carryback of losses. As of December 31, 2011, the Company had Federal NOL carryforwards available to offset future taxable income of approximately \$2.5 million that expire between 2028 and 2031. As of December 31, 2011, the Company had state NOL carryforwards available to offset future state taxable income of approximately \$41.2 million that expire between 2015 and 2031. In addition, the Company had various federal and state tax credit carryforwards combined of approximately \$17.4 million. Approximately \$8.1 million of the credit carryforwards are available to offset future tax liabilities and expire between 2025 and 2031. The remaining amount is available indefinitely. Certain of these carryforwards, when realized, will be credited to additional paid-in capital.

The total amount of gross unrecognized tax benefits was \$5.0 million as of December 31, 2011, all of which would affect Intevac's effective tax rate if realized. The aggregate changes in the balance of gross unrecognized tax benefits were as follows for the years ended December 31, 2011 and 2010:

|                                                              | 2011           | 2010     |
|--------------------------------------------------------------|----------------|----------|
|                                                              | (In thousands) |          |
| Beginning balance                                            | \$ 4,494       | \$ 782   |
| Additions based on tax positions related to the current year | 927            | 3,712    |
| Additions for tax positions of prior years                   |                |          |
| Reductions for tax positions of prior years                  |                |          |
| Settlements                                                  | (400)          |          |
| Lapse of statute of limitations                              |                |          |
| Ending balance                                               | \$ 5,021       | \$ 4,494 |

The unrecognized tax benefits may decrease in the next twelve months due to examinations by tax authorities. It is Intevac's policy to include interest and penalties related to unrecognized tax benefits in the provision for income taxes on the consolidated statements of operations. During fiscal 2011, Intevac recognized a net tax expense for interest of \$61,000. As of December 31, 2011 Intevac had \$65,000 of accrued interest related to unrecognized tax benefits, which was classified as a long-term liability in the consolidated balance sheets. Intevac did not accrue any penalties related to these unrecognized tax benefits because Intevac has other tax attributes which would offset any potential taxes due.

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

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 tax credit carry forwards remaining or utilized in an otherwise open year. During fiscal 2011, the California income tax examination for fiscal years ended 2005, 2006 and 2007 was completed. Due to an income tax refund generated by a carry-back claim, the Internal Revenue Service is currently conducting a review of the Company's fiscal year 2009 tax return. 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.

**10. Employee Benefit Plans*****Employee Savings and Retirement Plan***

In 1991, Intevac established a defined contribution retirement plan with 401(k) plan features. The plan covers all United States employees eighteen years and older. Employees may make contributions by a percentage reduction in their salaries, not to exceed the statutorily prescribed annual limit. Intevac made cash contributions of \$540,000, \$438,000 and \$109,000 for the years ended December 31, 2011, 2010, and 2009, respectively. Employees may choose among several investment options for their contributions and their share of Intevac's contributions, and they are able to move funds between investment options at any time. Intevac's common stock is not one of the investment options. Administrative expenses relating to the plan are insignificant.

***Employee Bonus Plans***

Intevac has various employee bonus plans. A profit-sharing plan provides for the distribution of a percentage of pre-tax profits to substantially all of Intevac's employees not eligible for other performance-based incentive plans, up to a maximum percentage of compensation. Other plans award annual or quarterly bonuses to Intevac's executives and key contributors based on the achievement of profitability and other specific performance criteria. Charges to expense under these plans were \$720,000 and \$7.6 million, respectively for the years ended December 31, 2011 and 2010. There were no charges to expense under these plans for the year ended December 31, 2009.

**11. Commitments and Contingencies*****Leases***

Intevac leases certain facilities under non-cancelable operating leases that expire at various times up to March 2017 and has options to renew most leases, with rentals to be negotiated. Certain of Intevac's leases contain provisions for rental adjustments. Included in other long-term assets on the consolidated balance sheets is \$786,000 of prepaid rent related to the effective rent on Intevac's long-term lease for Intevac's Santa Clara facility. The facility leases require Intevac to pay for all normal maintenance costs. Gross rental expense was approximately \$2.9 million, \$3.3 million and \$3.4 million for the years ended December 31, 2011, 2010, and 2009, respectively. Future minimum lease payments at December 31, 2011 totaled \$10.2 million and were: \$2.3 million for fiscal 2012; \$2.1 million for fiscal 2013; \$1.8 million for fiscal 2014; \$1.8 million for fiscal 2015; \$1.7 million for fiscal 2016 and \$401,000 for thereafter.

***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

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

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 Company 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.

**Warranty**

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

On the 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 consolidated statements of operations.

The following table displays the activity in the warranty provision account for 2011 and 2010:

|                                                      | 2011           | 2010     |
|------------------------------------------------------|----------------|----------|
|                                                      | (in thousands) |          |
| Beginning balance                                    | \$ 3,415       | \$ 1,602 |
| Expenditures incurred under warranties               | (2,169)        | (2,938)  |
| Accruals for product warranties                      | 1,543          | 4,292    |
| Adjustments to previously existing warranty accruals | (65)           | 459      |
| Ending balance                                       | \$ 2,724       | \$ 3,415 |

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

|                             | December 31,   |          |
|-----------------------------|----------------|----------|
|                             | 2011           | 2010     |
|                             | (in thousands) |          |
| Other accrued liabilities   | \$ 2,586       | \$ 2,612 |
| Other long-term liabilities | 138            | 803      |

|                          |          |          |
|--------------------------|----------|----------|
| Total warranty provision | \$ 2,724 | \$ 3,415 |
|--------------------------|----------|----------|

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INTEVAC, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Legal Matters*

From time to time, Intevac receives notification from third parties, including customers and suppliers, seeking indemnification, litigation support, payment of money or other actions in connection with claims made against them. In addition, from time to time, Intevac receives notification from third parties claiming that Intevac may be or is infringing their intellectual property or other rights. Intevac also is subject to various other legal proceedings and claims, both asserted and unasserted, that arise in the ordinary course of business. Although the outcome of these claims and proceedings cannot be predicted with certainty, Intevac does not believe that any of these other existing proceedings or claims will have a material adverse effect on its consolidated financial condition or results of operations.

**12. Segment and Geographic Information**

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 December 31, 2011 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed.

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

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

The Equipment segment designs, develops and markets manufacturing equipment and solutions to the hard disk drive industry and offers high-productivity technology solutions to the PV industry. The Equipment segment began offering solar cell processing systems for thin film applications in 2009 and for wafer-based crystalline silicon (c-Si) applications in 2010 to PV cell manufacturers. In 2010 the Equipment segment also began offering inspection equipment to PV cell manufacturers. 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 compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and the optical analysis of materials. Intevac provides sensors, cameras and systems for government applications such as night vision and long-range target identification and for commercial applications in the inspection, law enforcement, scientific and medical industries.

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Information for each reportable segment for the years ended December 31, 2011, 2010 and 2009 is as follows:

*Net Revenues*

|                            | 2011      | 2010<br>(in thousands) | 2009      |
|----------------------------|-----------|------------------------|-----------|
| Equipment                  | \$ 54,878 | \$ 168,252             | \$ 51,389 |
| Intevac Photonics          | 28,096    | 34,274                 | 26,592    |
| Total segment net revenues | \$ 82,974 | \$ 202,526             | \$ 77,981 |

*Operating Profit (Loss)*

|                                       | 2011        | 2010<br>(in thousands) | 2009        |
|---------------------------------------|-------------|------------------------|-------------|
| Equipment                             | \$ (20,321) | \$ 40,286              | \$ (8,826)  |
| Intevac Photonics                     | (4,141)     | (4,901)                | (4,133)     |
| Total segment operating profit (loss) | (24,462)    | 35,385                 | (12,959)    |
| Unallocated costs                     | (6,279)     | (4,147)                | (4,388)     |
| Operating income (loss)               | (30,741)    | 31,238                 | (17,347)    |
| Interest income                       | 847         | 899                    | 1,362       |
| Other income and expense, net         | (212)       | (126)                  | (108)       |
| Income (loss) before income taxes     | \$ (30,106) | \$ 32,011              | \$ (16,093) |

*Depreciation and amortization*

|                                                  | 2011     | 2010<br>(in thousands) | 2009     |
|--------------------------------------------------|----------|------------------------|----------|
| Equipment                                        | \$ 2,901 | \$ 3,129               | \$ 2,916 |
| Intevac Photonics                                | 1,369    | 1,354                  | 1,326    |
| Total segment depreciation and amortization      | 4,270    | 4,483                  | 4,242    |
| Unallocated costs                                | 1,153    | 1,378                  | 1,343    |
| Total consolidated depreciation and amortization | \$ 5,423 | \$ 5,861               | \$ 5,585 |

*Capital Additions*

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|                                             | 2011            | 2010            | 2009            |
|---------------------------------------------|-----------------|-----------------|-----------------|
|                                             |                 | (in thousands)  |                 |
| Equipment                                   | \$ 2,717        | \$ 1,540        | \$ 1,176        |
| Intevac Photonics                           | 2,148           | 5,167           | 938             |
| <b>Total segment capital additions</b>      | <b>4,865</b>    | <b>6,707</b>    | <b>2,114</b>    |
| Unallocated                                 | 717             | 348             | 501             |
| <b>Total consolidated capital additions</b> | <b>\$ 5,582</b> | <b>\$ 7,055</b> | <b>\$ 2,615</b> |

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

*Segment Assets*

|                                      | 2011              | 2010              |
|--------------------------------------|-------------------|-------------------|
|                                      | (in thousands)    |                   |
| Equipment                            | \$ 48,133         | \$ 57,130         |
| Intevac Photonics                    | 29,947            | 31,275            |
| <b>Total segment assets</b>          | <b>78,080</b>     | <b>88,405</b>     |
| Cash and investments                 | 114,822           | 137,380           |
| Deferred income taxes                | 23,919            | 17,718            |
| Other current assets                 | 6,848             | 5,889             |
| Common property, plant and equipment | 1,366             | 1,803             |
| Other assets                         | 786               | 576               |
| <b>Consolidated total assets</b>     | <b>\$ 225,821</b> | <b>\$ 251,771</b> |

Geographic revenue information for the three years ended December 31, 2011 is based on the location of the customer. Revenue from unaffiliated customers by geographic region/country was as follows:

|                           | 2011             | 2010              | 2009             |
|---------------------------|------------------|-------------------|------------------|
|                           | (in thousands)   |                   |                  |
| United States             | \$ 28,907        | \$ 47,554         | \$ 38,768        |
| Asia(*)                   | 47,325           | 149,456           | 38,144           |
| Europe                    | 6,128            | 5,000             | 1,069            |
| Rest of world             | 614              | 516               |                  |
| <b>Total net revenues</b> | <b>\$ 82,974</b> | <b>\$ 202,526</b> | <b>\$ 77,981</b> |

(\*) Revenues are attributable to the geographic area in which Intevac's customers are located. Net trade revenues in Asia include shipments to Singapore, China, Japan and Malaysia.

Net property, plant and equipment by geographic region at December 31 was as follows:

|                                            | 2011             | 2010             |
|--------------------------------------------|------------------|------------------|
|                                            | (in thousands)   |                  |
| United States                              | \$ 14,007        | \$ 13,268        |
| Asia                                       | 442              | 650              |
| <b>Net property, plant &amp; equipment</b> | <b>\$ 14,449</b> | <b>\$ 13,918</b> |

**13. Subsequent Event**

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On January 6, 2012, the Company sold certain assets with a net book value of \$900,000 which comprised its semiconductor mainframe technology for \$3.0 million in cash to Brooks Automation Inc. ( Brooks ).

## INTEVAC, INC.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## 14. Selected Quarterly Consolidated Financial Data (Unaudited)

|                        | Three Months Ended                    |                 |                 |                  |
|------------------------|---------------------------------------|-----------------|-----------------|------------------|
|                        | April 2,<br>2011                      | July 2,<br>2011 | Oct. 1,<br>2011 | Dec. 31,<br>2011 |
|                        | (in thousands, except per share data) |                 |                 |                  |
| Net sales              | \$ 17,423                             | \$ 27,585       | \$ 19,321       | \$ 18,645        |
| Gross profit           | 6,380                                 | 10,137          | 7,518           | 6,395            |
| Net loss               | (7,031)                               | (2,619)         | (6,116)         | (6,209)          |
| Basic loss per share   | \$ (0.31)                             | \$ (0.11)       | \$ (0.27)       | \$ (0.27)        |
| Diluted loss per share | \$ (0.31)                             | \$ (0.11)       | \$ (0.27)       | \$ (0.27)        |

|                          | Three Months Ended                    |                 |                 |                  |
|--------------------------|---------------------------------------|-----------------|-----------------|------------------|
|                          | April 3,<br>2010                      | July 3,<br>2010 | Oct. 2,<br>2010 | Dec. 31,<br>2010 |
|                          | (in thousands, except per share data) |                 |                 |                  |
| Net sales                | \$ 33,142                             | \$ 68,598       | \$ 64,627       | \$ 36,159        |
| Gross profit             | 14,478                                | 29,034          | 29,584          | 14,576           |
| Net income               | 1,430                                 | 12,337          | 13,179          | 1,103            |
| Basic income per share   | \$ 0.06                               | \$ 0.55         | \$ 0.59         | \$ 0.05          |
| Diluted income per share | \$ 0.06                               | \$ 0.54         | \$ 0.58         | \$ 0.05          |

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**Item 9. *Changes In and Disagreements With Accountants on Accounting and Financial Disclosure***

None.

**Item 9A. *Controls and Procedures***

**Management's Report on Assessment of Internal Controls Over Financial Reporting**

***Evaluation of Disclosure Controls and Procedures***

Based on Intevac's management's evaluation (with the participation of Intevac's chief executive officer and chief financial officer), as of the end of the period covered by this report, Intevac's chief executive officer and chief financial officer have concluded that Intevac's disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, (the Exchange Act)) are effective to ensure that information required to be disclosed by Intevac in reports that Intevac files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to Intevac's management, including Intevac's chief executive officer and chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

***Management's Report on Internal Control over Financial Reporting***

Management is responsible for establishing and maintaining adequate internal control over financial reporting for Intevac. Internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. Internal control over financial reporting includes those policies and procedures that: (i) pertain to the maintenance of records that in reasonable detail accurately and fairly reflect the transactions and dispositions of the assets of the Company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the Company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Management (with the participation of the chief executive officer and chief financial officer) conducted an evaluation of the effectiveness of Intevac's internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, management concluded that Intevac's internal control over financial reporting was effective as of December 31, 2011. Grant Thornton LLP, an independent registered public accounting firm, has audited the effectiveness of Intevac's internal control over financial reporting and has issued a report on Intevac's internal control over financial reporting, which is included in their report on the following page.

**Changes in Internal Control over Financial Reporting**

There was no change in our internal control over financial reporting during our fourth quarter of fiscal 2011 that has materially affected, or is reasonably likely to materially affect, Intevac's internal control over financial reporting.

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**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Intevac, Inc.

We have audited Intevac, Inc. (a Delaware corporation) and subsidiaries (collectively, the Company) internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management's Report on Assessment of Internal Controls Over Financial Reporting. Our responsibility is to express an opinion on the Company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Intevac, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of December 31, 2011, based on criteria established in *Internal Control – Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of the Company as of December 31, 2011 and 2010, and the related consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows for each of the three years in the period ended December 31, 2011. Our audits of the basic financial statements included the financial statement schedule listed in the index appearing under Item 15(a)(2). Our report dated February 21, 2012 expressed an unqualified opinion on those consolidated financial statements and schedule.

/s/ GRANT THORNTON LLP

San Jose, California

February 21, 2012

**Item 9B. Other Information**

None.

**PART III****Item 10. Directors, Executive Officers and Corporate Governance**

The information required by this item relating to the Company's directors and nominees, disclosure relating to compliance with Section 16(a) of the Securities Exchange Act of 1934, and information regarding Intevac's code of ethics, audit committee and stockholder recommendations for director nominees is included under the captions Election of Directors, Nominees, Business Experience of Nominees for Election as Directors, Board Meetings and Committees, Corporate Governance Matters, Section 16(a) Beneficial Ownership Reporting Compliance and Code of Business Conduct and Ethics in the Company's Proxy Statement for the 2012 Annual Meeting of Stockholders and is incorporated herein by reference. The information required by this item relating to the Company's executive officers and key employees is included under the caption Executive Officers of the Registrant under Item 1 in Part I of this Annual Report on Form 10-K.

**Item 11. Executive Compensation**

The information required by this item is included under the caption Executive Compensation and Related Information in the Company's Proxy Statement for the 2012 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

*Securities authorized for issuance under equity compensation plans.* The following table summarizes the number of outstanding options granted to employees and directors, as well as the number of securities remaining available for future issuance, under Intevac's equity compensation plans at December 31, 2011.

| Plan Category                                              | (a)<br>Number of securities<br>to be issued upon<br>exercise of<br>outstanding options,<br>warrants and rights | (b)<br>Weighted-average<br>exercise price of<br>outstanding options,<br>warrants and rights | (c)<br>Number of<br>securities<br>remaining available<br>for future issuance<br>under equity<br>compensation plans<br>(1) |
|------------------------------------------------------------|----------------------------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------|---------------------------------------------------------------------------------------------------------------------------|
| Equity compensation plans approved by security holders(2)  | 3,391,925                                                                                                      | \$ 12.03                                                                                    | 999,859                                                                                                                   |
| Equity compensation plans not approved by security holders |                                                                                                                |                                                                                             |                                                                                                                           |
| <b>Total</b>                                               | <b>3,391,925</b>                                                                                               | <b>\$ 12.03</b>                                                                             | <b>999,859</b>                                                                                                            |

(1) Excludes securities reflected in column (a).

(2) Included in the column (c) amount are 301,592 shares available for future issuance under Intevac's 2003 Employee Stock Purchase Plan. The other information required by this item is included under the caption Ownership of Securities in the Company's Proxy Statement for the 2012 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 13. *Certain Relationships and Related Transactions, and Director Independence***

The information required by this item is included under the captions "Certain Transactions" and "Corporate Governance Matters" in the Company's Proxy Statement for the 2012 Annual Meeting of Stockholders and is incorporated herein by reference.

**Item 14. Principal Accountant Fees and Services**

The information required by this item is included under the caption Fees Paid To Accountants For Services Rendered During 2011 in the Company's Proxy Statement for the 2012 Annual Meeting of Stockholders and is incorporated herein by reference.

**PART IV**

**Item 15. Exhibits and Financial Statement Schedules**

a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Financial Statements:

See Index to Consolidated Financial Statements in Part II, Item 8 of this Form 10-K.

2. Financial Statement Schedule:

Schedule II Valuation and Qualifying Accounts

All other schedules have been omitted since the required information is not present in amounts sufficient to require submission of the schedule or because the information required is included in the consolidated financial statements or notes thereto.

3. Exhibits

| Exhibit   | Description                                                                                                                                                                          |
|-----------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1(1)    | Certificate of Incorporation of the Registrant                                                                                                                                       |
| 3.2(2)    | Bylaws of the Registrant, as amended                                                                                                                                                 |
| 10.1 +(3) | The Registrant's 1995 Stock Option/Stock Issuance Plan, as amended                                                                                                                   |
| 10.2 +(4) | The Registrant's 2003 Employee Stock Purchase Plan, as amended                                                                                                                       |
| 10.3 +(5) | The Registrant's 2004 Equity Incentive Plan, as amended                                                                                                                              |
| 10.4(6)   | Lease, dated February 5, 2001 regarding the space located at 3510, 3544, 3560, 3570 and 3580 Bassett Street, Santa Clara, California, including the First through Seventh Amendments |
| 10.6 +(3) | The Registrant's 401(k) Profit Sharing Plan                                                                                                                                          |
| 10.9(7)   | Director and Officer Indemnification Agreement                                                                                                                                       |
| 10.11+(8) | The Registrant's Executive Incentive Plan                                                                                                                                            |
| 10.12+(8) | Employment Agreement of Kevin Fairbairn dated January 24, 2002, as amended                                                                                                           |
| 21.1      | Subsidiaries of the Registrant                                                                                                                                                       |
| 23.1      | Consent of Independent Registered Public Accounting Firm                                                                                                                             |
| 24.1      | Power of Attorney (see page 73)                                                                                                                                                      |
| 31.1      | Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002                                                                     |
| 31.2      | Certification of 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 Document *                                                                                                                                            |
| 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 *                                                                                                                             |

- (1) Previously filed as an exhibit to the Company's Report on Form 8-K filed July 23, 2007

(2) Previously filed as an exhibit to the Company's Report on Form 8-K filed November 19, 2008

(3) Previously filed as an exhibit to the Registration Statement on Form S-1 (No. 33-97806)

(4) Previously filed as an exhibit to the Company's Form 10-Q filed May 3, 2011

(5) Previously filed as an exhibit to the Company's Form 10-Q filed May 3, 2011

(6) Previously filed as an exhibit to the Company's Form 10-K filed February 25, 2011

(7) Previously filed as an exhibit to the Company's Form 10-K filed March 14, 2008

(8) Previously filed as an exhibit to the Company's Form 10-K filed March 4, 2009

+ Management compensatory plan or arrangement required to be filed as an exhibit pursuant to Item 15(c) of Form 10-K

\* 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 under those sections.

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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, on February 21, 2012.

**INTEVAC, INC.**

/s/ JEFFREY ANDRESON  
 Jeffrey Andreson  
 Executive Vice President, Finance and Administration,

Chief Financial Officer, Treasurer and Secretary

**POWER OF ATTORNEY**

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Kevin Fairbairn and Jeffrey Andreson and each of them, as his true and lawful attorneys-in-fact and agents, with full power of substitution and resubstitution, for him and in his name, place and stead, in any and all capacities, to sign any and all amendments (including post-effective amendments) to this Report on Form 10-K, and to file the same, with all exhibits thereto, and other documents in connection therewith, with the Securities and Exchange Commission, granting unto said attorneys-in-fact and agents, and each of them, full power and authority to do and perform each and every act and thing requisite and necessary to be done in connection therewith, as fully to all intents and purposes as he might or could do in person, hereby ratifying and confirming all that said attorneys-in-fact and agents, or any of them, or their or his substitute or substitutes, may lawfully do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

| <b>Signature</b>                           | <b>Title</b>                                                                                                                                                | <b>Date</b>       |
|--------------------------------------------|-------------------------------------------------------------------------------------------------------------------------------------------------------------|-------------------|
| /s/ KEVIN FAIRBAIRN<br>(Kevin Fairbairn)   | President, Chief Executive Officer and<br>Director (Principal Executive Officer)                                                                            | February 21, 2012 |
| /s/ NORMAN H. POND<br>(Norman H. Pond)     | Chairman of the Board                                                                                                                                       | February 21, 2012 |
| /s/ JEFFREY ANDRESON<br>(Jeffrey Andreson) | Executive Vice President, Finance and<br>Administration, Chief Financial Officer<br>Treasurer and Secretary (Principal<br>Financial and Accounting Officer) | February 21, 2012 |
| /s/ DAVID S. DURY<br>(David S. Dury)       | Director                                                                                                                                                    | February 21, 2012 |
| /s/ STANLEY J. HILL<br>(Stanley J. Hill)   | Director                                                                                                                                                    | February 21, 2012 |
| /s/ THOMAS M. ROHRS                        | Director                                                                                                                                                    | February 21, 2012 |

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(Thomas M. Rohrs)

/s/ JOHN F. SCHAEFER  
(John F. Schaefer)

Director

February 21, 2012

/s/ PING YANG  
(Ping Yang)

Director

February 21, 2012

## Schedule

## SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

## INTEVAC, INC.

| Description                     | Balance at<br>Beginning<br>of Period | Additions (Reductions)                            |                                               | Deductions - Describe<br>(In thousands) | Balance at<br>End<br>of Period |
|---------------------------------|--------------------------------------|---------------------------------------------------|-----------------------------------------------|-----------------------------------------|--------------------------------|
|                                 |                                      | Charged<br>(Credited)<br>to Costs and<br>Expenses | Charged<br>(Credited)<br>to Other<br>Accounts |                                         |                                |
| Year ended December 31, 2009:   |                                      |                                                   |                                               |                                         |                                |
| Deducted from asset accounts:   |                                      |                                                   |                                               |                                         |                                |
| Allowance for doubtful accounts | \$ 145                               | \$ 133                                            | \$                                            | \$ 145(1)                               | \$ 133                         |
| Year ended December 31, 2010:   |                                      |                                                   |                                               |                                         |                                |
| Deducted from asset accounts:   |                                      |                                                   |                                               |                                         |                                |
| Allowance for doubtful accounts | \$ 133                               | \$                                                | \$                                            | \$ 78(1)                                | \$ 55                          |
| Year ended December 31, 2011:   |                                      |                                                   |                                               |                                         |                                |
| Deducted from asset accounts:   |                                      |                                                   |                                               |                                         |                                |
| Allowance for doubtful accounts | \$ 55                                | \$ 41                                             | \$                                            | \$ 55(1)                                | \$ 41                          |

(1) Write-offs of amounts deemed uncollectible.