

INTEVAC INC  
Form 10-Q  
July 30, 2013  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(MARK ONE)

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

For the quarterly period ended June 29, 2013

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 0-26946

**INTEVAC, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

94-3125814  
(IRS Employer Identification No.)

3560 Bassett Street

Santa Clara, California 95054

(Address of principal executive office, including Zip Code)

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

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

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

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

Large accelerated filer       Accelerated filer       Non-accelerated filer       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

On July 30, 2013, 23,793,138 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

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**INTEVAC, INC.**

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

|  | June 29,<br>2013                    | December 31,<br>2012 |
|--|-------------------------------------|----------------------|
|  | (Unaudited)                         |                      |
|  | (In thousands, except<br>par value) |                      |
| <b>ASSETS</b>  |                                     |                      |
| Current assets:  |                                     |                      |
| Cash and cash equivalents  | \$ 22,250                           | \$ 24,261            |
| Short-term investments   | 46,344                              | 40,591               |
| Trade and other accounts receivable, net of allowances of \$0 at both June 29, 2013 and at December 31, 2012 | 17,542                              | 19,822               |
| Inventories  | 25,625                              | 26,193               |
| Prepaid expenses and other current assets  | 1,289                               | 2,120                |
| Total current assets   | 113,050                             | 112,987              |
| Property, plant and equipment, net   | 12,328                              | 13,426               |
| Long-term investments  | 19,701                              | 27,317               |
| Intangible assets, net of amortization of \$2,926 at June 29, 2013 and \$2,887 at December 31, 2012          | 5,459                               | 5,868                |
| Deferred income taxes and other long-term assets   | 14,114                              | 12,905               |
| Total assets   | \$ 164,652                          | \$ 172,503           |
| <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>   |                                     |                      |
| Current liabilities:   |                                     |                      |
| Accounts payable   | \$ 6,491                            | \$ 4,479             |
| Accrued payroll and related liabilities  | 4,663                               | 4,194                |
| Other accrued liabilities  | 4,520                               | 8,489                |
| Customer advances  | 8,317                               | 2,193                |
| Deferred income taxes  | 1,281                               | 1,281                |
| Total current liabilities  | 25,272                              | 20,636               |
| Other long-term liabilities  | 9,328                               | 9,232                |
| Stockholders' equity:  |                                     |                      |
| Common stock, \$0.001 par value  | 24                                  | 23                   |
| Additional paid-in capital   | 154,187                             | 151,996              |
| Accumulated other comprehensive income   | 670                                 | 769                  |
| Accumulated deficit  | (24,829)                            | (10,153)             |
| Total stockholders' equity   | 130,052                             | 142,635              |
| Total liabilities and stockholders' equity   | \$ 164,652                          | \$ 172,503           |

Note: Amounts as of December 31, 2012 are derived from the December 31, 2012 audited consolidated financial statements.

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See accompanying notes to the condensed consolidated financial statements.

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

|   | Three Months Ended    |                  | Six Months Ended |                  |
|---|-----------------------|------------------|------------------|------------------|
|   | June 29,<br>2013      | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
|   | (Unaudited)           |                  |                  |                  |
|   | (In thousands, except |                  |                  |                  |
|   | per share amounts)    |                  |                  |                  |
| Net revenues:                               |                       |                  |                  |                  |
| Systems and components                      | \$ 13,234             | \$ 28,634        | \$ 22,120        | \$ 43,402        |
| Technology development                      | 3,749                 | 3,157            | 7,845            | 5,705            |
| Total net revenues                          | 16,983                | 31,791           | 29,965           | 49,107           |
| Cost of net revenues:                       |                       |                  |                  |                  |
| Systems and components                      | 10,173                | 15,266           | 16,480           | 24,086           |
| Technology development                      | 2,981                 | 2,271            | 6,142            | 3,943            |
| Total cost of net revenues                  | 13,154                | 17,537           | 22,622           | 28,029           |
| Gross profit                                | 3,829                 | 14,254           | 7,343            | 21,078           |
| Operating expenses:                         |                       |                  |                  |                  |
| Research and development                    | 5,584                 | 8,263            | 11,943           | 17,476           |
| Selling, general and administrative         | 5,235                 | 6,669            | 11,206           | 13,442           |
| Total operating expenses                    | 10,819                | 14,932           | 23,149           | 30,918           |
| Gain (loss) on divestitures                 |                       |                  | (208)            | 2,207            |
| Loss from operations                        | (6,990)               | (678)            | (16,014)         | (7,633)          |
| Interest income and other, net              | 92                    | 48               | 172              | 420              |
| Loss before income taxes                    | (6,898)               | (630)            | (15,842)         | (7,213)          |
| Provision for (benefit from) income taxes   | (486)                 | 863              | (1,166)          | (2,559)          |
| Net loss                                    | \$ (6,412)            | \$ (1,493)       | \$ (14,676)      | \$ (4,654)       |
| Net loss per share:                         |                       |                  |                  |                  |
| Basic and diluted                           | \$ (0.27)             | \$ (0.06)        | \$ (0.62)        | \$ (0.20)        |
| Weighted average common shares outstanding: |                       |                  |                  |                  |
| Basic and diluted                           | 23,785                | 23,265           | 23,724           | 23,241           |

See accompanying notes to the condensed consolidated financial statements.

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

|   | <b>Three Months Ended</b>                       |                 | <b>Six Months Ended</b> |                 |
|---|---|-----------------|-------------------------|-----------------|
|   | <b>June 29,</b>                                 | <b>June 30,</b> | <b>June 29,</b>         | <b>June 30,</b> |
|   | <b>2013</b>                                     | <b>2012</b>     | <b>2013</b>             | <b>2012</b>     |
|   | <b>(Unaudited)</b>                              |                 |                         |                 |
|   | <b>(In thousands, except per share amounts)</b> |                 |                         |                 |
| Net loss  | \$ (6,412)                                      | \$ (1,493)      | \$ (14,676)             | \$ (4,654)      |
| Other comprehensive income (loss), before tax                     |   |                 |                         |                 |
| Change in unrealized net loss on available-for-sale investments   | (74)  | 101             | (89)                    | 232             |
| Foreign currency translation losses                               | (4)   | (26)            | (10)                    | (14)            |
| Other comprehensive income (loss), before tax                     | (78)  | 75              | (99)                    | 218             |
| Income tax benefit related to items in other comprehensive income |   | (35)            |                         | (81)            |
| Other comprehensive income (loss), net of tax                     | (78)  | 40              | (99)                    | 137             |
| Comprehensive loss  | \$ (6,490)                                      | \$ (1,453)      | \$ (14,775)             | \$ (4,517)      |

See accompanying notes to the condensed consolidated financial statements.

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

|  | Six months ended |                  |
|--|------------------|------------------|
|  | June 29,<br>2013 | June 30,<br>2012 |
|  | (Unaudited)      |                  |
|  | (In thousands)   |                  |
| <b>Operating activities</b>  |                  |                  |
| Net loss   | \$ (14,676)      | \$ (4,654)       |
| Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities: |                  |                  |
| Depreciation and amortization  | 2,093            | 2,299            |
| Net amortization of investment premiums and discounts  | 431              | 758              |
| Net loss on sale of investments  |                  | 210              |
| Equity-based compensation  | 1,082            | 1,998            |
| Change in the fair value of acquisition-related contingent consideration                         | (209)            | 643              |
| Deferred income taxes  | (1,324)          | (2,373)          |
| Loss (gain) on divestitures  | 208              | (2,207)          |
| Changes in operating assets and liabilities  | 8,242            | (7,108)          |
| Total adjustments  | 10,523           | (5,780)          |
| Net cash and cash equivalents used in operating activities                                       | (4,153)          | (10,434)         |
| <b>Investing activities</b>  |                  |                  |
| Purchases of investments   | (24,384)         | (32,987)         |
| Proceeds from sales and maturities of investments  | 25,727           | 32,647           |
| Proceeds from sale of DeltaNu assets   | 500              |                  |
| Proceeds from sale of mainframe technology   |                  | 3,000            |
| Purchases of leasehold improvements and equipment  | (835)            | (1,667)          |
| Net cash and cash equivalents provided by (used in) investing activities                         | 1,008            | 993              |
| <b>Financing activities</b>  |                  |                  |
| Payment of acquisition-related contingent consideration  |                  | (2,389)          |
| Net proceeds from issuance of common stock   | 1,144            | 882              |
| Net cash and cash equivalents provided by (used in) financing activities                         | 1,144            | (1,507)          |
| Effect of exchange rate changes on cash and cash equivalents                                     | (10)             | (14)             |
| Net decrease in cash and cash equivalents  | (2,011)          | (10,962)         |
| Cash and cash equivalents at beginning of period   | 24,261           | 23,560           |
| Cash and cash equivalents at end of period   | \$ 22,250        | \$ 12,598        |

See accompanying notes to the condensed consolidated financial statements.



**Table of Contents****INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****1. Basis of Presentation**

In the opinion of management, the unaudited interim condensed consolidated financial statements of Intevac, Inc. and its subsidiaries (Intevac or the Company) included herein have been prepared on a basis consistent with the December 31, 2012 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Intevac's Annual Report on Form 10-K for the fiscal year ended December 31, 2012 (2012 Form 10-K). Intevac's results of operations for the six months ended June 29, 2013 are not necessarily indicative of future operating results.

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

**2. Inventories**

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

|                  | June 29,<br>2013 | December 31,<br>2012 |
|------------------|------------------|----------------------|
|                  | (In thousands)   |                      |
| Raw materials    | \$ 15,080        | \$ 14,921            |
| Work-in-progress | 7,508            | 5,526                |
| Finished goods   | 3,037            | 5,746                |
|                  | \$ 25,625        | \$ 26,193            |

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

**3. Equity-Based Compensation**

At June 29, 2013, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan, the 2004 Equity Incentive Plan (the Plans) and the 2003 Employee Stock Purchase Plan (the ESPP). Intevac's stockholders approved all of these plans. The Plans permit the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, restricted stock units (RSUs also referred to as performance units) and performance shares.

The ESPP provides that eligible employees may purchase Intevac's common stock through payroll deductions at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase interval. Offering periods are generally two years in length, and consist of a series of six-month purchase intervals. Eligible employees may join the ESPP at the beginning of any six-month purchase interval. Under the terms of the ESPP, employees can choose to have up to 15% of their base earnings withheld to purchase Intevac common stock.

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

The effect of recording equity-based compensation for the three and six months ended June 29, 2013 and June 30, 2012 was as follows:

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | June 29,<br>2013   | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
|   | (In thousands)     |                  |                  |                  |
| Equity-based compensation by type of award: |                    |                  |                  |                  |
| Stock options                               | \$ 104             | \$ 587           | \$ 277           | \$ 1,320         |
| RSUs  | 108                | 17               | 184              | 23               |
| Employee stock purchase plan                | 307                | 340              | 621              | 655              |
| Total equity-based compensation             | 519                | 944              | 1,082            | 1,998            |
| Tax effect on equity-based compensation     | (5)                | (222)            | (10)             | (501)            |
| Net effect on net loss                      | \$ 514             | \$ 722           | \$ 1,072         | \$ 1,497         |

Equity-based compensation expense is based on awards ultimately expected to vest and such amount has been reduced for estimated forfeitures. Forfeitures were estimated based on Intevac's historical experience, which Intevac believes to be indicative of Intevac's future experience.

**Stock Options and ESPP**

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

Option activity as of June 29, 2013 and changes during the six months ended June 29, 2013 were as follows:

|  | Shares    | Weighted Average<br>Exercise Price |
|--|-----------|------------------------------------|
| Options outstanding at December 31, 2012     | 3,128,408 | \$ 11.52                           |
| Options granted                              | 419,775   | \$ 4.50                            |
| Options cancelled and forfeited              | (511,133) | \$ 13.19                           |
| Options exercised                            | (67,438)  | \$ 3.91                            |
| Options outstanding at June 29, 2013         | 2,969,612 | \$ 10.40                           |
| Vested and expected to vest at June 29, 2013 | 2,804,636 | \$ 10.63                           |
| Options exercisable at June 29, 2013         | 2,107,841 | \$ 11.73                           |

Intevac issued 246,000 shares under the ESPP during the six months ended June 29, 2013.



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

Intevac estimated the weighted-average fair value of stock options and employee stock purchase rights using the following weighted-average assumptions:

|   | Three Months Ended |                  | Six Months Ended |                  |
|---|--------------------|------------------|------------------|------------------|
|   | June 29,<br>2013   | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
| <b>Stock Options:</b>                           |                    |                  |                  |                  |
| Weighted-average fair value of grants per share | \$ 2.11            | \$ 3.83          | \$ 2.10          | \$ 3.92          |
| Expected volatility                             | 58.04%             | 63.58%           | 57.95%           | 63.81%           |
| Risk free interest rate                         | 1.18%              | 0.69%            | 1.16%            | 0.74%            |
| Expected term of options (in years)             | 4.5                | 4.6              | 4.4              | 4.6              |
| Dividend yield                                  | None               | None             | None             | None             |

|   | Six Months Ended |                  |
|---|------------------|------------------|
|   | June 29,<br>2013 | June 30,<br>2012 |
| <b>Stock Purchase Rights:</b>                   |                  |                  |
| Weighted-average fair value of grants per share | \$ 1.60          | \$ 3.49          |
| Expected volatility                             | 52.42%           | 61.77%           |
| Risk free interest rate                         | 0.26%            | 0.33%            |
| Expected term of purchase rights (in years)     | 1.85             | 1.56             |
| Dividend yield                                  | None             | None             |

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

**RSUs**

A summary of the RSU activity is as follows:

|                                      | Shares   | Weighted Average         |
|--------------------------------------|----------|--------------------------|
|                                      |          | Grant Date<br>Fair Value |
| Non-vested RSUs at December 31, 2012 | 100,461  | \$ 7.33                  |
| Granted                              | 168,762  | \$ 4.51                  |
| Vested                               | (21,077) | \$ 7.63                  |
| Cancelled and forfeited              | (10,922) | \$ 7.34                  |
| Non-vested RSUs at June 29, 2013     | 237,224  | \$ 5.30                  |

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

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

Performance-based RSUs ( performance-based awards ) granted to certain executive officers are also subject to the achievement of specified performance goals. These performance-based awards become eligible to vest only if performance goals are achieved and then actually will vest only if the grantee remains employed by Intevac through each applicable vesting date. The fair value of these performance-based awards is estimated on the date of grant and assumes that the specified performance goals will be achieved. If the goals are achieved, these awards vest over a specified remaining service period, provided that the grantee remains employed by Intevac through each scheduled vesting date. If the performance goals are not met, no compensation expense is recognized and any previously recognized compensation expense is reversed. The expected cost of each award is reflected over the service period and is reduced for estimated forfeitures. For performance-based awards granted during fiscal 2013, the performance goals require the achievement of targeted revenues and adjusted annual operating profit levels measured at the end of two and three-year periods.

**4. Purchased Intangible Assets**

Intevac's indefinite-lived intangible asset consisted of in-process research and development ( IPR&D ) in the amount of \$4.0 million in the Equipment segment. During the quarter ended June 29, 2013, the related development project was completed, the product achieved commercialization and Intevac began amortizing the intangible asset over its expected useful life of 7 years. Immediately prior to commencement of amortization Intevac tested the intangible asset for impairment and determined that it was not impaired.

Details of finite-lived intangible assets by segment as of June 29, 2013, are as follows.

|                   | Gross<br>Carrying<br>Amount | June 29, 2013<br>Accumulated<br>Amortization<br>(In thousands) | Net<br>Carrying<br>Amount |
|-------------------|-----------------------------|--|---------------------------|
| Equipment         | \$ 7,170                    | \$ (2,298)   | \$ 4,872                  |
| Intevac Photonics | 1,215                       | (628)  | 587                       |
|                   | \$ 8,385                    | \$ (2,926)   | \$ 5,459                  |

Total amortization expense of finite-lived intangibles for the three and six months ended June 29, 2013 was \$183,000 and \$319,000.

As of June 29, 2013, future amortization expense is expected to be as follows.

| <b>(In thousands)</b> |          |
|-----------------------|----------|
| 2013                  | \$ 557   |
| 2014                  | 934      |
| 2015                  | 854      |
| 2016                  | 853      |
| 2017                  | 757      |
| Thereafter            | 1,504    |
|                       | \$ 5,459 |

**5. Acquisition-Related Contingent Consideration**

In connection with the acquisition of Solar Implant Technologies, Inc. ( SIT ), Intevac agreed to pay up to an aggregate of \$7.0 million in cash to the selling shareholders if certain milestones were achieved over a specified period. Intevac has made payments to the selling shareholders for achievement of the first milestone in 2011 and for

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

achievement of the second and third milestones in 2012. The fourth and final milestone was not achieved on the targeted date outlined in the acquisition agreement and will not be paid. There is no remaining contingent consideration obligation associated with the milestone payments at June 29, 2013.

In connection with the acquisition of SIT, Intevac also agreed to pay to the selling shareholders in cash 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. Intevac estimated the fair value of this contingent consideration on June 29, 2013 based on probability-based forecasted revenues reflecting Intevac's own assumptions concerning future revenue from such products. As of June 29, 2013, Intevac has not made any payments associated with the revenue earnout obligation.

The fair value measurement of contingent consideration is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the statement of operations. The following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the three and six month periods ended June 29, 2013 and June 30, 2012:

|                       | Three Months Ended |                  | Six Months Ended |                  |
|-----------------------|--------------------|------------------|------------------|------------------|
|                       | June 29,<br>2013   | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
|                       | (In thousands)     |                  |                  |                  |
| Opening balance       | \$ 5,262           | \$ 8,993         | \$ 5,151         | \$ 8,715         |
| Changes in fair value | (320)              | 365              | (209)            | 643              |
| Cash payments made    |                    | (2,389)          |                  | (2,389)          |
| Closing balance       | \$ 4,942           | \$ 6,969         | \$ 4,942         | \$ 6,969         |

The following table displays the balance sheet classification of the contingent consideration liability account at June 29, 2013 and at December 31, 2012:

|  | June 29,<br>2013 | December 31,<br>2012 |
|--|------------------|----------------------|
|  | (In thousands)   |                      |
| Other accrued liabilities                          | \$ 77            | \$ 265               |
| Other long-term liabilities                        | 4,865            | 4,886                |
| Total acquisition-related contingent consideration | \$ 4,942         | \$ 5,151             |

The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the contingent consideration liability as of June 29, 2013. Significant increases or decreases in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement.

**Quantitative Information about Level 3 Fair Value Measurements at June 29, 2013**

| Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|------------|---------------------|--------------------|--------------------------|
|------------|---------------------|--------------------|--------------------------|



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(In thousands, except for percentages)

|                 |          |                      |  |                       |
|-----------------|----------|----------------------|--|-----------------------|
| Revenue Earnout | \$ 4,942 | Discounted cash flow | Weighted average cost of capital                     | 16.0%                 |
|                 |          |                      | Probability weighting of achieving revenue forecasts | 15.0% - 50.0% (31.7%) |

### 6. Divestitures

#### *Sale of DeltaNu*

On March 29, 2013, the Company sold certain assets, including existing tangible and intangible assets, which comprised its Raman spectroscopy instruments product line, also known as DeltaNu, for consideration not to exceed

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\$1.5 million. Under the terms of the agreement, the acquirer also assumed certain liabilities related to the purchased assets. Payment terms included \$500,000 which was paid on the closing date, with the remaining balance to be paid in the form of an earnout of 5% of the acquirer's Raman spectroscopy instrument sales for 5 years following the closing date which will be due and payable on or before each anniversary of the closing date or a minimum earnout payment of \$100,000 annually, whichever is higher. The maximum earnout payments during the payment period shall not exceed \$1.0 million.

As the earnout is collected over an extended period of time and in management's judgment the degree of collectibility is uncertain, Intevac did not recognize the minimum earnout payments upon closing, but instead will record income in the period when the minimum earnout payments can be reasonably estimated for that period and payment is assured.

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

|                               |          |
|-------------------------------|----------|
| Cash proceeds                 | \$ 500   |
| Assets sold:                  |          |
| Accounts receivable           | 147      |
| Inventories                   | 320      |
| Other current assets          | 27       |
| Property, plant and equipment | 159      |
| Trade name                    | 90       |
| Total assets sold             | 743      |
| Liabilities divested:         |          |
| Accounts payable              | 59       |
| Other accrued expenses        | 6        |
| Total liabilities divested    | 65       |
| Transaction and other costs   | 30       |
| Loss on sale                  | \$ (208) |

***Sale of Mainframe Technology***

On January 6, 2012, the Company sold certain assets including intellectual property and residual assets which comprised its semiconductor mainframe technology to Brooks Automation Inc.

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

|               |          |
|---------------|----------|
| Cash proceeds | \$ 3,000 |
| Assets sold:  |          |
| Inventories   | 589      |

|                               |          |
|-------------------------------|----------|
| Property, plant and equipment | 178      |
| Transaction and other costs   | 26       |
| Gain on sale                  | \$ 2,207 |

**7. Warranty**

Intevac provides for the estimated cost of warranty when revenue is recognized. Intevac's warranty is per contract terms, and for systems sold directly the warranty typically ranges between 12 and 24 months from customer acceptance. For systems sold through a distributor, Intevac offers a 3 month warranty. The remainder of any warranty period is the responsibility of the distributor. During this warranty period any defective non-consumable

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parts are replaced and installed at no charge to the customer. The warranty period on consumable parts is limited to their reasonable usable lives. Intevac uses estimated repair or replacement costs along with its historical warranty experience to determine its warranty obligation. Intevac generally provides a twelve month warranty on its Intevac Photonics products. The provision for the estimated future costs of warranty is based upon historical cost and product performance experience. Intevac exercises judgment in determining the underlying estimates.

On the condensed consolidated balance sheets, the short-term portion of the warranty provision is included in other accrued liabilities, while the long-term portion is included in other long-term liabilities. The expense associated with product warranties issued or adjusted is included in cost of net revenues on the condensed consolidated statements of operations.

The following table displays the activity in the warranty provision account for the three and six months ended June 29, 2013 and June 30, 2012:

|  | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
|  | <b>June 29,<br/>2013</b>  | <b>June 30,<br/>2012</b> | <b>June 29,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|  | (In thousands)            |                          |                          |                          |
| Opening balance  | \$ 2,225                  | \$ 2,494                 | \$ 2,349                 | \$ 2,724                 |
| Expenditures incurred under warranties                             | (210)                     | (410)                    | (464)                    | (1,190)                  |
| Accruals for product warranties issued during the reporting period | 329                       | 447                      | 538                      | 874                      |
| Adjustments to previously existing warranty accruals               | (257)                     | 327                      | (336)                    | 450                      |
| Closing balance  | \$ 2,087                  | \$ 2,858                 | \$ 2,087                 | \$ 2,858                 |

The following table displays the balance sheet classification of the warranty provision account at June 29, 2013 and at December 31, 2012:

|                             | <b>June 29,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|-----------------------------|--------------------------|------------------------------|
|                             | (In thousands)           |                              |
| Other accrued liabilities   | \$ 1,997                 | \$ 2,259                     |
| Other long-term liabilities | 90                       | 90                           |
| Total warranty provision    | \$ 2,087                 | \$ 2,349                     |

**8. Guarantees*****Officer and Director Indemnifications***

As permitted or required under Delaware law and to the maximum extent allowable under that law, Intevac has certain obligations to indemnify its current and former officers and directors for certain events or occurrences while the officer or director is, or was serving, at Intevac's request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the 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.

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

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

**9. Cash, Cash Equivalents and Investments**

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

|  | Amortized<br>Cost | June 29, 2013<br>Unrealized Holding Gains      Unrealized Holding Losses |              | Fair Value       |
|--|-------------------|--|--------------|------------------|
|  |                   | (In thousands)   |              |                  |
| <b>Cash and cash equivalents:</b>                    |                   |  |              |                  |
| Cash   | \$ 5,412          | \$   | \$           | \$ 5,412         |
| Money market funds                                   | 15,835            |  |              | 15,835           |
| Corporate bonds and medium-term notes                | 1,004             |  | 1            | 1,003            |
| <b>Total cash and cash equivalents</b>               | <b>\$ 22,251</b>  | <b>\$</b>  | <b>\$ 1</b>  | <b>\$ 22,250</b> |
| <b>Short-term investments:</b>                       |                   |  |              |                  |
| Corporate bonds and medium-term notes                | \$ 20,445         | \$ 19  | \$ 11        | \$ 20,453        |
| Municipal bonds                                      | 3,200             | 4  |              | 3,204            |
| U.S. treasury and agency securities                  | 22,474            | 18   |              | 22,492           |
| Variable rate demand notes (VRDNs)                   | 195               |  |              | 195              |
| <b>Total short-term investments</b>                  | <b>\$ 46,314</b>  | <b>\$ 41</b>   | <b>\$ 11</b> | <b>\$ 46,344</b> |
| <b>Long-term investments:</b>                        |                   |  |              |                  |
| Corporate bonds and medium-term notes                | \$ 14,659         | \$ 1   | \$ 42        | \$ 14,618        |
| Municipal bonds                                      | 1,075             |  | 1            | 1,074            |
| U.S. treasury and agency securities                  | 4,010             |  | 1            | 4,009            |
| <b>Total long-term investments</b>                   | <b>\$ 19,744</b>  | <b>\$ 1</b>  | <b>\$ 44</b> | <b>\$ 19,701</b> |
| <b>Total cash, cash equivalents, and investments</b> | <b>\$ 88,309</b>  | <b>\$ 42</b>   | <b>\$ 56</b> | <b>\$ 88,295</b> |

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|  | Amortized<br>Cost | December 31, 2012<br>Unrealized<br>Holding<br>Gains |              | Unrealized<br>Holding<br>Losses | Fair Value       |
|--|-------------------|---|--------------|---------------------------------|------------------|
|  |                   | (In thousands)                                      |              |                                 |                  |
| <b>Cash and cash equivalents:</b>                    |                   |   |              |                                 |                  |
| Cash   | \$ 5,939          | \$  |              | \$                              | \$ 5,939         |
| Money market funds                                   | 18,322            |   |              |                                 | 18,322           |
| <b>Total cash and cash equivalents</b>               | <b>\$ 24,261</b>  | <b>\$</b>   |              | <b>\$</b>                       | <b>\$ 24,261</b> |
| <b>Short-term investments:</b>                       |                   |   |              |                                 |                  |
| Commercial paper                                     | \$ 2,495          | \$  |              | \$                              | \$ 2,495         |
| Corporate bonds and medium-term notes                | 19,539            |   | 13           | 4                               | 19,548           |
| Municipal bonds                                      | 1,203             |   | 1            |                                 | 1,204            |
| U.S. treasury and agency securities                  | 16,976            |   | 23           |                                 | 16,999           |
| VRDNs  | 345               |   |              |                                 | 345              |
| <b>Total short-term investments</b>                  | <b>\$ 40,558</b>  | <b>\$ 37</b>  | <b>\$ 4</b>  | <b>\$</b>                       | <b>\$ 40,591</b> |
| <b>Long-term investments:</b>                        |                   |   |              |                                 |                  |
| Corporate bonds and medium-term notes                | \$ 16,776         | \$ 33   |              | \$ 7                            | \$ 16,802        |
| Municipal bonds                                      | 1,000             |   | 2            |                                 | 1,002            |
| U.S. treasury and agency securities                  | 9,499             |   | 14           |                                 | 9,513            |
| <b>Total long-term investments</b>                   | <b>\$ 27,275</b>  | <b>\$ 49</b>  | <b>\$ 7</b>  | <b>\$</b>                       | <b>\$ 27,317</b> |
| <b>Total cash, cash equivalents, and investments</b> | <b>\$ 92,094</b>  | <b>\$ 86</b>  | <b>\$ 11</b> | <b>\$</b>                       | <b>\$ 92,169</b> |

The contractual maturities of available-for-sale securities at June 29, 2013 are presented in the following table.

|                                 | Amortized<br>Cost | Fair Value       |
|---------------------------------|-------------------|------------------|
|                                 | (In thousands)    |                  |
| Due in one year or less         | \$ 60,951         | \$ 60,979        |
| Due after one through two years | 20,751            | 20,709           |
| Due after ten years             | 1,195             | 1,195            |
|                                 | <b>\$ 82,897</b>  | <b>\$ 82,883</b> |

The following table provides the fair market value of Intevac's investments with unrealized losses that are not deemed to be other-than temporarily impaired as of June 29, 2013.

| June 29, 2013                               |  |
|---|--|
| In Loss Position for<br>Less than 12 Months | In Loss Position for<br>Greater than 12 Months |
|   |  |

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|                                       | Fair Value     | Gross<br>Unrealized<br>Losses | Fair Value | Gross<br>Unrealized<br>Losses |
|---------------------------------------|----------------|-------------------------------|------------|-------------------------------|
|                                       | (In thousands) |                               |            |                               |
| Corporate bonds and medium-term notes | \$ 25,418      | \$ 54                         | \$         | \$                            |
| Municipal bonds                       | 2,074          | 1                             |            |                               |
| U.S. treasury and agency securities   | 2,012          | 1                             |            |                               |
|                                       | \$ 29,504      | \$ 56                         | \$         | \$                            |



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

The following table represents the fair value hierarchy of Intevac's available-for-sale securities measured at fair value on a recurring basis as of June 29, 2013.

|   | Fair Value Measurements at June 29, 2013 |           |           |
|---|--|-----------|-----------|
|   | Total                                    | Level 1   | Level 2   |
|   | (In thousands)                           |           |           |
| Recurring fair value measurements:      |  |           |           |
| Available-for-sale securities           |  |           |           |
| Money market funds                      | \$ 15,835                                | \$ 15,835 | \$        |
| U.S. treasury and agency securities     | 26,501                                   | 8,699     | 17,802    |
| Corporate bonds and medium-term notes   | 36,074                                   |           | 36,074    |
| Municipal bonds                         | 4,278                                    |           | 4,278     |
| VRDNs                                   | 195                                      |           | 195       |
| Total recurring fair value measurements | \$ 82,883                                | \$ 24,534 | \$ 58,349 |

The following table presents the changes in Level 3 instruments which consisted of Auction Rate Securities ( ARS ) which were classified as available-for-sale securities and which were measured on a recurring basis for both the three and six month periods ended June 30, 2012.

| (In thousands)                         |          |
|--|----------|
| Opening balance                        | \$ 4,490 |
| Total gains (losses) for the period    |          |
| Included in earnings                   | (229)    |
| Included in other comprehensive income | 171      |
| Proceeds from tender offers            | (2,771)  |
| Closing balance                        | \$ 1,661 |

The Company did not hold any ARS as of or during the six months ended June 29, 2013.

**10. Derivative Instruments**

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The Company uses foreign currency forward contracts to mitigate variability in gains and losses generated from the re-measurement of certain monetary assets and liabilities denominated in foreign currencies. These hedges do not qualify for special hedge accounting treatment. These derivatives are carried at fair value with changes recorded in interest income and other, net in the condensed consolidated statements of operations. Changes in the fair value of these

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derivatives are largely offset by re-measurement of the underlying assets and liabilities. Cash flows from such derivatives are classified as operating activities. The derivatives have maturities of approximately thirty and sixty days. The notional amount of Company's foreign currency derivatives was \$1.9 million at June 29, 2013 and \$491,000 at December 31, 2012.

**11. Accumulated Other Comprehensive Income**

The changes in accumulated other comprehensive income by component for the three and six months ended June 29, 2013, are as follows.

|   | Foreign<br>currency | Unrealized<br>holding gains<br>on<br>available-<br>for-sale<br>investments<br>(In thousands) | Total  |
|---|---------------------|--|--------|
| Balance at December 31, 2012                              | \$ 694              | \$ 75  | \$ 769 |
| Other comprehensive income (loss) before reclassification | (6)                 | (15)   | (21)   |
| Amounts reclassified from other comprehensive income      |                     |  |        |
| Net current-period other comprehensive income (loss)      | (6)                 | (15)   | (21)   |
| Balance at March 30, 2013                                 | \$ 688              | \$ 60  | \$ 748 |
| Other comprehensive income (loss) before reclassification | (4)                 | (74)   | (78)   |
| Amounts reclassified from other comprehensive income      |                     |  |        |
| Net current-period other comprehensive income (loss)      | (4)                 | (74)   | (78)   |
| Balance at June 29, 2013                                  | \$ 684              | \$ (14)  | \$ 670 |

**12. Net Loss Per Share**

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

|  | Three Months Ended                       |                  | Six Months Ended |                  |
|--|--|------------------|------------------|------------------|
|  | June 29,<br>2013                         | June 30,<br>2012 | June 29,<br>2013 | June 30,<br>2012 |
|  | (In thousands, except per share amounts) |                  |                  |                  |
| Net loss                                   | \$ (6,412)                               | \$ (1,493)       | \$ (14,676)      | \$ (4,654)       |
| Weighted-average shares basic              | 23,785                                   | 23,265           | 23,724           | 23,241           |
| Effect of dilutive potential common shares |  |                  |                  |                  |
| Weighted-average shares diluted            | 23,785                                   | 23,265           | 23,724           | 23,241           |

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|   |           |           |           |           |
|---|-----------|-----------|-----------|-----------|
| Net loss per share - basic and diluted                | \$ (0.27) | \$ (0.06) | \$ (0.62) | \$ (0.20) |
| Antidilutive shares based on employee awards excluded | 2,690     | 2,871     | 2,696     | 2,910     |

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

### 13. Segment Reporting

Intevac's two reportable segments are: Equipment and Intevac Photonics. Intevac's chief operating decision-maker has been identified as the President and CEO, who reviews operating results to make decisions about

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allocating resources and assessing performance for the entire Company. Segment information is presented based upon Intevac's management organization structure as of June 29, 2013 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, gains and losses on divestitures and sales of intellectual property, and unallocated costs in measuring the performance of the reportable segments.

The Equipment segment designs, develops and markets vacuum process equipment solutions for high-volume manufacturing of small substrates with precise thin film properties for hard drive and solar 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. Intevac provides sensors, cameras and systems for government applications such as night vision and long-range target identification.

Information for each reportable segment for the three and six months ended June 29, 2013 and June 30, 2012 is as follows:

***Net Revenues***

|                                   | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|-----------------------------------|---------------------------|--------------------------|--------------------------|--------------------------|
|                                   | <b>June 29,<br/>2013</b>  | <b>June 30,<br/>2012</b> | <b>June 29,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|                                   | <b>(In thousands)</b>     |                          |                          |                          |
| Equipment                         | \$ 9,164                  | \$ 25,059                | \$ 14,532                | \$ 35,778                |
| Intevac Photonics                 | 7,819                     | 6,732                    | 15,433                   | 13,329                   |
| <b>Total segment net revenues</b> | <b>\$ 16,983</b>          | <b>\$ 31,791</b>         | <b>\$ 29,965</b>         | <b>\$ 49,107</b>         |

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|  | <b>Three Months Ended</b> |                          | <b>Six Months Ended</b>  |                          |
|--|---------------------------|--------------------------|--------------------------|--------------------------|
|  | <b>June 29,<br/>2013</b>  | <b>June 30,<br/>2012</b> | <b>June 29,<br/>2013</b> | <b>June 30,<br/>2012</b> |
|  | <b>(In thousands)</b>     |                          |                          |                          |
| Equipment  | \$ (5,841)                | \$ 1,129                 | \$ (13,183)              | \$ (5,196)               |
| Intevac Photonics                                  | 253                       | (616)                    | 62                       | (1,656)                  |
| <b>Total income (loss) from segment operations</b> | <b>(5,588)</b>            | <b>513</b>               | <b>(13,121)</b>          | <b>(6,852)</b>           |
| Unallocated costs                                  | (1,402)                   | (1,191)                  | (2,685)                  | (2,988)                  |
| Gain (loss) on divestitures                        |                           |                          | (208)                    | 2,207                    |
| Loss from operations                               | (6,990)                   | (678)                    | (16,014)                 | (7,633)                  |
| Interest income and other, net                     | 92                        | 48                       | 172                      | 420                      |
| Loss before income taxes                           | \$ (6,898)                | \$ (630)                 | \$ (15,842)              | \$ (7,213)               |

Total assets for each reportable segment as of June 29, 2013 and December 31, 2012 are as follows:

**Assets**

|  | <b>June 29,<br/>2013</b> | <b>December 31,<br/>2012</b> |
|--|--------------------------|------------------------------|
|  | <b>(In thousands)</b>    |                              |
| Equipment                              | \$ 37,139                | \$ 37,376                    |
| Intevac Photonics                      | 22,853                   | 27,052                       |
| <b>Total segment assets</b>            | <b>59,992</b>            | <b>64,428</b>                |
| Cash, cash equivalents and investments | 88,295                   | 92,169                       |
| Deferred income taxes                  | 13,500                   | 12,176                       |
| Other current assets                   | 965                      | 1,870                        |
| Common property, plant and equipment   | 1,369                    | 1,211                        |
| Other assets                           | 531                      | 649                          |
| <b>Consolidated total assets</b>       | <b>\$ 164,652</b>        | <b>\$ 172,503</b>            |

**14. Restructuring Charges**

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On February 1, 2013, Intevac announced the 2013 cost reduction plan (the Plan ) to reduce expenses including a reduction in its workforce. Implementation of the Plan was substantially completed in the first half of fiscal 2013 and the Company reduced its workforce by 18 percent. The cost of implementing the Plan was reported under cost of products sold and operating expenses in the condensed consolidated statements of operations. Substantially all cash outlays in connection with the Plan occurred in the first half of fiscal 2013. Implementation of the Plan is expected to reduce salary, wages and other employee-related expenses by approximately \$5.5 million to \$6.0 million on an annual basis.

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The changes in restructuring reserves associated with the Plan for the three and six months ended June 29, 2013, are as follows.

|                                      | <b>Severance and<br/>other employee-<br/>related costs<br/>(In thousands)</b> |
|--------------------------------------|---|
| Balance at December 31, 2012         | \$  |
| Provision for restructuring reserves | 502   |
| Cash payments made                   | (461)   |
| Balance at March 30, 2013            | \$ 41   |
| Provision for restructuring reserves | 240   |
| Cash payments made                   | (281)   |
| Balance at June 29, 2013             | \$  |

**15. Income Taxes**

Intevac recorded income tax benefits of \$486,000 and \$1.2 million for the three and six months ended June 29, 2013, respectively. Intevac recorded an income tax provision of \$863,000 and an income tax benefit of \$2.6 million for the three and six months ended June 30, 2012, respectively. The income tax provision for the three and six month periods are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates, except that certain discrete items are treated separately. At the end of 2012 Intevac established a valuation allowance against the majority of the U.S. deferred tax assets. As a result, Intevac did not recognize a benefit on the U.S. net operating loss for the three and six months ended June 29, 2013.

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

Intevac's tax rate differs from the applicable statutory rates due primarily to establishment of valuation allowances, 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 has benefitted from a tax holiday in Singapore which is scheduled to expire at the end of 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 are presently in discussion with the Singapore tax authority to terminate this tax holiday effective January 1, 2013 due to current conditions in the hard disk drive business, which will not allow Intevac to be able to meet the conditions required to continue benefitting from the tax holiday. We expect the Singapore tax authorities to issue the terms and conditions allowing us to terminate the tax holiday early during the third quarter of 2013.





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**INTEVAC, INC.**

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

**(Unaudited)**

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 2007. Tax years 1999 through 2007 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. Tax years 2008 through 2012 generally remain open for examinations by the tax authorities. During 2012, the Internal Revenue Service completed its review of the Company's fiscal year 2009 tax return which arose from an income tax refund generated by a carry-back claim. Additionally, the Singapore Inland Revenue Authority is conducting an examination of the fiscal 2009 and 2010 tax returns 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.

**16. Contingencies**

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

**17. Subsequent Event**

At Intevac's Annual Meeting of Stockholders, held on May 9, 2013, Intevac's stockholders approved an Employee Stock Option Exchange Program (the Exchange Program) to permit eligible employees to exchange, on a grant-by-grant basis, eligible outstanding options that are significantly underwater (that is, the option's exercise price was greater than the quoted market price at the time the Exchange Program was launched) for a lesser number of options, to be granted under the 2012 Equity Incentive Plan. The Exchange Program offer period began on July 9, 2013 and is expected to end on August 6, 2013, unless we extend the offer period. The Exchange Program is open to all employees in the United States and Singapore except for the Named Executive Officers. Non-employee members of our board of directors are also not eligible to participate. Options eligible for the Exchange Program are those options that were granted prior to July 9, 2012, and that have exercise prices per share that are greater than \$8.49, which approximates 50% above our closing per share stock price measured as of July 5, 2013 which is shortly before the start of the Exchange Program.

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

This Quarterly Report on Form 10-Q contains forward-looking statements, which involve risks and uncertainties. Words such as "believes," "expects," "anticipates" and the like indicate forward-looking statements. These forward-looking statements include comments related to Intevac's shipments, projected revenue recognition, product costs, gross margin, operating expenses, interest income, income taxes, cash balances and financial results in 2013 and beyond; projected customer requirements for Intevac's new and existing products, and when, and if, Intevac's customers will place orders for these products; Intevac's ability to proliferate its Photonics technology into major military programs and to develop and introduce commercial imaging products; the timing of delivery and/or acceptance of the systems and products that comprise Intevac's backlog for revenue and the Company's ability to achieve cost savings. Intevac's actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under "Risk Factors" and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed on February 22, 2013, and our periodic Form 10-Q's and Form 8-K's.

**Overview**

Intevac provides process manufacturing equipment solutions to the hard disk drive industry and high-productivity process manufacturing equipment to the photovoltaic (PV) industry. Intevac also provides sensors, cameras and systems for government applications such as night vision and long-range target identification. Intevac's customers include manufacturers of hard disk drives and PV cells as well as the U.S. government and its agencies and contractors. Intevac reports two segments: Equipment and Intevac Photonics. During the first quarter of 2012, Intevac sold certain assets comprising its semiconductor mainframe technology. During the first quarter of 2013, Intevac sold certain assets comprising its Raman spectroscopy instruments product line, also known as DeltaNu. During the first quarter of 2013, Intevac announced a cost reduction plan and reduced its workforce by 18 percent during the first half of the year.

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 are sold primarily through Intevac's direct sales force. Intevac also sells its products through distributors in Japan and China.

Intevac's results are driven by worldwide demand for hard disk drives, which in turn depends on the growth in digital data creation and storage, the rate of areal density improvements, the end-user demand for personal computers, enterprise data storage, including on-line, cloud storage and near-line applications, personal audio and video players and video game platforms that include such drives. Demand for Intevac's equipment is impacted by Intevac's customers' relative market share positions and production capacity needs. Intevac continues to execute its strategy of equipment diversification into new markets by introducing products for PV solar cell manufacturing. Intevac believes that expansion into this market, which is significantly larger than the hard disk drive deposition equipment market, will result in incremental equipment revenues for Intevac and decrease Intevac's dependence on the hard disk drive industry. Intevac's equipment business is subject to cyclical industry conditions, as demand for manufacturing equipment and services can change depending on supply and demand for hard disk drives and PV cells, as well as other factors such as global economic conditions and technological advances in fabrication processes.

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The following table presents certain significant measurements for the three and six months ended June 29, 2013 and June 30, 2012:

|                        | Three months ended                                       |                  |                             | Six months ended |                  |                             |
|------------------------|--|------------------|-----------------------------|------------------|------------------|-----------------------------|
|                        | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior period | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior period |
|                        | (In thousands, except percentages and per share amounts) |                  |                             |                  |                  |                             |
| Net revenues           | \$ 16,983  | \$ 31,791        | \$ (14,808)                 | \$ 29,965        | \$ 49,107        | \$ (19,142)                 |
| Gross profit           | \$ 3,829   | \$ 14,254        | \$ (10,425)                 | \$ 7,343         | \$ 21,078        | \$ (13,735)                 |
| Gross margin percent   | 22.5%  | 44.8%            | (22.3) points               | 24.5%            | 42.9%            | (18.4) points               |
| Net loss               | \$ (6,412)   | \$ (1,493)       | \$ (4,919)                  | \$ (14,676)      | \$ (4,654)       | \$ (10,022)                 |
| Loss per diluted share | \$ (0.27)  | \$ (0.06)        | \$ (0.21)                   | \$ (0.62)        | \$ (0.20)        | \$ (0.42)                   |

Net revenues decreased for the second quarter and first six months for fiscal 2013 compared to the same periods in the prior year primarily due to lower equipment sales to disk manufacturers offset in part by higher Intevac Photonics contract research and development ( R&D ). Intevac did not recognize revenue on any 200 Lean systems in the first half of fiscal 2013 compared to two 200 Lean systems in the first half of fiscal 2012. In the second quarter of 2013, Intevac recognized revenue on its first production system for its solar implant ENERGi product. Net revenues for the second quarter of fiscal 2013 compared to the same period in the prior year also reflected higher sales levels of our low-light camera modules. The net loss for the second quarter and first six months of fiscal 2013 increased compared to the same periods in the prior year due to lower revenues, lower gross margins, and recognition of a smaller income tax benefit, offset in part by lower operating expenses as a result of savings from the cost reduction program implemented during the first half of 2013. Also in the first half of fiscal 2012, Intevac recognized a gain on the sale of semiconductor mainframe technology in the amount of \$2.2 million which did not re-occur in the first half of fiscal 2013. The income tax benefit declined from \$2.6 million in the prior year to \$1.2 million in the first half of fiscal 2013 primarily due to the fact that Intevac did not recognize a benefit on the U.S. net operating loss in the first half of fiscal 2013.

In fiscal 2013, Intevac expects that the effect of macro-economic environment conditions on demand for personal computers from consumers and corporations, the transition to centralized or cloud storage and the proliferation of tablets will continue to negatively impact the hard drive equipment business. The Company therefore expects that shipments of Intevac equipment to hard disk drive manufacturers will be approximately at the same levels as fiscal 2012. In fiscal 2013, Intevac expects sales of PV equipment to solar cell manufacturers to increase slightly compared to fiscal 2012. Intevac expects that capital spending for the solar cell manufacturing market will remain at these low levels through the remainder of 2013 and into 2014. For fiscal 2013, Intevac expects that Intevac Photonics business levels will be relatively flat as compared to 2012 as the business completes its major contract with the U.S. Army to develop a pilot night vision system for the Apache helicopter in advance of the first large scale production shipments that will begin in late 2013.

Intevac's trademarks, include the following: 200 Lean®, AccuLuber®, EBAPS®, ENERGi®, I-Port®, LEAN SOLAR®, LithoPrime®, MicroVista®, NanoVista®, LEAN SOLAR NanoTexture®, NightVista®, and Night Port

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

|                    | Three months ended |                  |  | Six months ended |                  |                                |
|--------------------|--------------------|------------------|--|------------------|------------------|--------------------------------|
|                    | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| Equipment          | \$ 9,164           | \$ 25,059        | \$ (15,895)                                      | \$ 14,532        | \$ 35,778        | \$ (21,246)                    |
| Intevac Photonics  |                    |                  |  |                  |                  |                                |
| Contract R&D       | 3,749              | 3,157            | 592  | 7,845            | 5,705            | 2,140                          |
| Products           | 4,070              | 3,575            | 495  | 7,588            | 7,624            | (36)                           |
| Intevac Photonics  | 7,819              | 6,732            | 1,087  | 15,433           | 13,329           | 2,104                          |
| Total net revenues | \$ 16,983          | \$ 31,791        | \$ (14,808)                                      | \$ 29,965        | \$ 49,107        | \$ (19,142)                    |

Equipment revenue for the three and six months ended June 29, 2013 decreased over the same periods in the prior year as a result of lower sales of disk sputtering systems, technology upgrades and spare parts. During the second quarter of 2013 Intevac recognized revenue on one solar implant ENERGi system, disk equipment technology upgrades, spare parts and service. Intevac Equipment did not recognize revenue on any 200 Lean systems. During the second quarter of 2012 Intevac recognized revenue on two 200 Lean systems, two AccuLuber™ systems, one LEAN SOLAR NanoTexture etch system, disk equipment technology upgrades, and spare parts. Equipment revenue for the six months ended June 29, 2013 included revenue recognition for one solar implant ENERGi system, two AccuLuber systems, upgrades and spare parts. Equipment revenue for the six months ended June 30, 2012 included revenue recognition for two 200 Lean systems, six AccuLuber systems, one PV etch system, upgrades and spare parts.

Intevac Photonics revenue for the three and six month periods ended June 29, 2013 increased over the same periods in the prior year as a result of increased contract R&D work. The increase in contract R&D revenue was the result of a higher volume of contracts related to two large U.S. government defense programs and due to the continued expansion of Intevac's low-light camera and sensor products in military applications. The increase in product revenue for the three months ended June 29, 2013 over the same period in the prior year was a result of higher sales levels of our low-light camera modules. Both the three and six month periods ended June 29, 2013 reflected lower sales of Raman spectroscopy products compared to the same periods in the prior year. On March 29, 2013, Intevac sold certain assets comprising its Raman spectroscopy instruments product line, also known as DeltaNu, and no longer offers Raman spectroscopy products.

*Backlog*

|                   | June 29,<br>2013 | December 31,<br>2012<br>(In thousands) | June 30,<br>2012 |
|-------------------|------------------|--|------------------|
| Equipment         | \$ 29,295        | \$ 8,902                               | \$ 14,588        |
| Intevac Photonics | 48,295           | 26,282                                 | 28,692           |
| Total backlog     | \$ 77,590        | \$ 35,184                              | \$ 43,280        |

Equipment backlog at June 29, 2013 included three 200 Lean systems. Equipment backlog at December 31, 2012 and June 30, 2012 did not include any 200 Lean systems. Photonics backlog at June 29, 2013 includes \$26.0 million in revenue that will be earned beyond the next twelve months.



**Table of Contents***Revenue by geographic region*

|                           | Three months ended |                  |  | Six months ended |                  |                                |
|---------------------------|--------------------|------------------|--|------------------|------------------|--------------------------------|
|                           | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| United States             | \$ 9,714           | \$ 6,814         | \$ 2,900   | \$ 17,047        | \$ 12,658        | \$ 4,389                       |
| Asia                      | 5,881              | 24,085           | (18,204)   | 10,366           | 33,929           | (23,563)                       |
| Europe                    | 1,388              | 890              | 498  | 2,552            | 2,518            | 34                             |
| Rest of world             |                    | 2                | (2)  |                  | 2                | (2)                            |
| <b>Total net revenues</b> | <b>\$ 16,983</b>   | <b>\$ 31,791</b> | <b>\$ (14,808)</b>                               | <b>\$ 29,965</b> | <b>\$ 49,107</b> | <b>\$ (19,142)</b>             |

International sales include products shipped to overseas operations of U.S. companies. The increase in domestic sales for the three and six months ended June 29, 2013 was primarily due to increased contract R&D. The decrease in international sales for the three and six months ended June 29, 2013 was primarily due to a decrease in net revenues from 200 Lean and AccuLuber systems and technology upgrades offset in part by higher sales of Intevac Photonics digital night-vision cameras to a NATO customer. The mix of domestic versus international sales will change from period to period depending on the location of Intevac's largest customers in each period.

*Gross profit*

|                                     | Three months ended |                  |  | Six months ended |                  |                                |
|-------------------------------------|--------------------|------------------|--|------------------|------------------|--------------------------------|
|                                     | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands, except percentages) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| Equipment gross profit              | \$ 1,352           | \$ 11,810        | \$ (10,458)  | \$ 2,554         | \$ 16,646        | \$ (14,092)                    |
| % of Equipment net revenues         | 14.8%              | 47.1%            |  | 17.6%            | 46.5%            |                                |
| Intevac Photonics gross profit      | \$ 2,477           | \$ 2,444         | \$ 33  | \$ 4,789         | \$ 4,432         | \$ 357                         |
| % of Intevac Photonics net revenues | 31.7%              | 36.3%            |  | 31.0%            | 33.2%            |                                |
| <b>Total gross profit</b>           | <b>\$ 3,829</b>    | <b>\$ 14,254</b> | <b>\$ (10,425)</b>   | <b>\$ 7,343</b>  | <b>\$ 21,078</b> | <b>\$ (13,735)</b>             |
| % of net revenues                   | 22.5%              | 44.8%            |  | 24.5%            | 42.9%            |                                |

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

Equipment gross margin was 14.8% in the three months ended June 29, 2013 compared to 47.1% in the three months ended June 30, 2012 and was 17.6% in the six months ended June 29, 2013 compared to 46.5% in the six months ended June 30, 2012. The lower gross margin was due primarily to a lower system margin on the first solar implant ENERGi system, lower systems, upgrade and spares shipments and lower factory utilization. Gross margins in the Equipment business will vary depending on a number of factors, including product mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

Intevac Photonics gross margin was 31.7% in the three months ended June 29, 2013 compared to 36.3% in the three months ended June 30, 2012 and was 31.0% in the six months ended June 29, 2013 compared to 33.2% in the six months ended June 30, 2012. Although revenue increased during the three and six months ended June 29, 2013 compared to the same periods in the prior year, gross margin percentages declined compared to the prior year periods due to a higher mix of lower-margin contract R&D work. Gross margins in the Intevac Photonics business will vary depending on a number of factors, including product mix, product cost, pricing, factory utilization, and provisions for excess and obsolete inventory.





**Table of Contents***Research and development*

|                                  | Three months ended |                  |  | Six months ended |                  |                                |
|----------------------------------|--------------------|------------------|--|------------------|------------------|--------------------------------|
|                                  | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| Research and development expense | \$ 5,584           | \$ 8,263         | \$ (2,679)                                       | \$ 11,943        | \$ 17,476        | \$ (5,533)                     |

Research and development spending decreased in Equipment and in Intevac Photonics during the three and six month periods ended June 29, 2013 as compared to the same periods in the prior year. The decrease in Equipment spending was due primarily to decreased PV development. The decrease in Intevac Photonics research and development was due to a higher volume of billable contract R&D efforts. Research and development expenses do not include costs of \$3.0 million and \$6.1 million for the three and six months ended June 29, 2013 respectively, or \$2.3 million and \$3.9 million for the three and six months ended June 30, 2012, respectively, which are related to customer-funded contract R&D programs at Intevac Photonics and therefore included in cost of net revenues.

*Selling, general and administrative*

|   | Three months ended |                  |  | Six months ended |                  |                                |
|---|--------------------|------------------|--|------------------|------------------|--------------------------------|
|   | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| Selling, general and administrative expense | \$ 5,235           | \$ 6,669         | \$ (1,434)                                       | \$ 11,206        | \$ 13,442        | \$ (2,236)                     |

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs. The decrease in selling, general and administrative spending in the three and six months ended June 29, 2013 compared to the three and six months ended June 30, 2012 was primarily the result of lower charges associated with the change in the fair value of the contingent consideration obligations related to the SIT acquisition, lower equity compensation expense and savings from the global cost reduction program offset in part by increased accruals for variable compensation programs and costs associated with the implementation of the global cost reduction program.

*Indefinite-lived intangible asset*

Intevac acquired 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 was the initial development of Intevac's ENERGi ion implantation process module for use in the manufacturing of PV solar cells. Intevac completed development on this process module during the second quarter of fiscal 2013. Upon completion of development and commercialization of the product, Intevac began amortization of the acquired IPR&D over its expected useful life of 7 years.

Immediately prior to the commencement of amortization, the Company assessed the valuation of the IPR&D from the SIT acquisition. 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 and no impairment existed.

**Table of Contents***2013 Cost reduction plan*

During the first quarter of fiscal 2013, Intevac announced the 2013 cost reduction plan (the Plan) to reduce expenses including a reduction in its workforce. Implementation of the Plan was substantially completed in the first half of fiscal 2013 and the workforce was reduced by 18 percent. The total cost of implementing the Plan was \$742,000 of which \$315,000 was reported under cost of products sold and \$427,000 was reported under operating expenses. Substantially all cash outlays in connection with the Plan occurred in the first half of fiscal 2013. Implementation of the Plan is expected to reduce salary, wages and other employee-related expenses by approximately \$5.5 million to \$6.0 million on an annual basis.

*Gain (loss) on divestitures*

On March 29, 2013, the Company sold certain assets, including existing tangible and intangible assets, which comprised its Raman spectroscopy instruments product line, also known as DeltaNu, for consideration not to exceed \$1.5 million, of which \$500,000 was received in cash upon closing, and recorded a loss of \$208,000. On January 6, 2012, the Company sold certain assets, including intellectual property and residual assets, which comprised its semiconductor mainframe technology for \$3.0 million in cash and recorded a gain of \$2.2 million. See Note 6 Divestitures in the notes to the condensed consolidated financial statements for additional information related to the gain (loss) on divestitures.

*Interest income and other, net*

|                                | Three months ended |                  |  | Six months ended |                  |                                |
|--------------------------------|--------------------|------------------|--|------------------|------------------|--------------------------------|
|                                | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| Interest income and other, net | \$ 92              | \$ 48            | \$ 44  | \$ 172           | \$ 420           | \$ (248)                       |

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

*Income tax provision (benefit)*

|                                | Three months ended |                  |  | Six months ended |                  |                                |
|--------------------------------|--------------------|------------------|--|------------------|------------------|--------------------------------|
|                                | June 29,<br>2013   | June 30,<br>2012 | Change over<br>prior<br>period<br>(In thousands) | June 29,<br>2013 | June 30,<br>2012 | Change over<br>prior<br>period |
| Income tax provision (benefit) | \$ (486)           | \$ 863           | \$ (1,349)                                       | \$ (1,166)       | \$ (2,559)       | \$ 1,393                       |

Intevac recorded income tax benefits of \$486,000 and \$1.2 million for the three and six months ended June 29, 2013, respectively. Intevac recorded an income tax provision of \$863,000 and an income tax benefit of \$2.6 million for the three and six months ended June 30, 2012, respectively. The income tax provision for the three and six months periods are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates, except that certain discrete items are treated separately. At the end of 2012 Intevac established a valuation allowance against the majority of the U.S. deferred tax assets. As a result, Intevac did not recognize a benefit on the U.S. net operating loss for the three and six months ended June 29, 2013.

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

Intevac's tax rate differs from the applicable statutory rates due primarily to establishment of valuation allowances, 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 has benefitted from a tax holiday in Singapore which is scheduled to expire at the end of 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 are presently in discussion with the Singapore tax authority to terminate this tax holiday effective January 1, 2013 due to current conditions in the hard disk drive business, which will not allow Intevac to be able to meet the conditions required to continue benefitting from the tax holiday. We expect the Singapore tax authorities to issue the terms and conditions allowing us to terminate the tax holiday early during the third quarter of 2013.

**Liquidity and Capital Resources**

At June 29, 2013, Intevac had \$88.3 million in cash, cash equivalents, and investments compared \$92.2 million at December 31, 2012. During the first six months of 2013 cash, cash equivalents and investments decreased by \$3.9 million due primarily to cash used in operating activities and purchases of fixed assets, partially offset by cash received from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans, and cash received from the sale of the assets of DeltaNu.

Cash, cash equivalents and investments consist of the following:

|  | June 29,<br>2013 | December 31,<br>2012 |
|--|------------------|----------------------|
|  | (In thousands)   |                      |
| Cash and cash equivalents                    | \$ 22,250        | \$ 24,261            |
| Short-term investments                       | 46,344           | 40,591               |
| Long-term investments                        | 19,701           | 27,317               |
| Total cash, cash equivalents and investments | \$ 88,295        | \$ 92,169            |

Operating activities used cash of \$4.2 million during the first six months of 2013 and of \$10.4 million during the first six months of 2012. The decrease in cash used in operating activities was due primarily changes in working capital during the first six months of 2013, which was mostly offset by a larger net loss.

Accounts receivable totaled \$17.5 million at June 29, 2013, compared to \$19.8 million at December 31, 2012. The decrease of \$2.3 million in the receivable balance was due primarily to lower revenue levels and the collection of outstanding receivables from the U.S. government. Total net inventories decreased slightly to \$25.6 million at June 29, 2013, compared to \$26.2 million at December 31, 2012 as the Company commenced building three 200 Lean systems to be shipped in the fourth quarter of 2013 and continues to carry inventories to support its next generation PV products. Accounts payable increased to \$6.5 million at June 29, 2013 compared to \$4.5 million at December 31, 2012. The increase of \$2.0 million in the accounts payable balance was due primarily to procurement of inventory for the production of three 200 Lean systems. Customer deposits increased to \$8.3 million at June 29, 2013 compared to \$2.2 million at December 31, 2012. The increase of \$6.1 million in the customer deposit balance was due primarily to deposits invoiced on orders received for three 200 Lean systems in the second quarter of 2013.

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Investing activities in the first six months of 2013 generated cash of \$1.0 million. Proceeds from sales and maturities of investments net of purchases totaled \$1.3 million. On March 29, 2013, the Company sold certain assets which comprised its Raman spectroscopy instruments product line, also known as DeltaNu, and received \$500,000 in cash upon closing. See Note 6 "Divestitures" in the notes to the condensed consolidated financial statements for additional information related the sale of the assets of DeltaNu. Capital expenditures for the six months ended June 29, 2013 were \$835,000.

Financing activities in the first six months of 2013 generated cash of \$1.1 million from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

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

As of June 29, 2013, approximately \$12.0 million of cash and cash equivalents and \$4.2 million of investments were domiciled in foreign tax jurisdictions. Intevac expects a significant portion of these funds to remain off shore in the short term. If the Company chose to repatriate these funds to the United States, it would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

Intevac believes that its existing cash, cash equivalents and investments will be sufficient to meet its cash requirements for the foreseeable future. Intevac intends to undertake approximately \$5.0 million to \$5.5 million in capital expenditures during the remainder of 2013.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ( "US GAAP" ) requires management to make judgments, assumptions and estimates that affect the amounts reported. Intevac's significant accounting policies are described in Note 1 to the consolidated financial statements included in Item 8 of Intevac's Annual Report on Form 10-K filed on February 22, 2013. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

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

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

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For further information about Intevac's other critical accounting policies, see the discussion of critical accounting policies in Intevac's 2012 Form 10-K. Management believes that there has been no significant change during the six months ended June 29, 2013 to the items identified as critical accounting policies in Intevac's 2012 Form 10-K.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

*Interest rate risk.* Intevac's exposure to market risk for changes in interest rates relates primarily to its investment portfolio. Intevac does not use derivative financial instruments in Intevac's investment portfolio. 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, obligations of the U.S. government and its agencies, corporate debt securities, municipal bonds and VRDNs.

The table below presents principal amounts and related weighted-average interest rates by year of expected maturity for Intevac's investment portfolio at June 29, 2013.

|                               | 2013                               | 2014      | 2015     | Total     | Fair Value |
|-------------------------------|------------------------------------|-----------|----------|-----------|------------|
|                               | (In thousands, except percentages) |           |          |           |            |
| <b>Cash equivalents</b>       |                                    |           |          |           |            |
| Fixed rate amounts            | \$ 1,004                           |           |          | \$ 1,004  | \$ 1,003   |
| Weighted-average rate         | 3.39%                              |           |          |           |            |
| Variable rate amounts         | \$ 15,835                          |           |          | \$ 15,835 | \$ 15,835  |
| Weighted-average rate         | 0.02%                              |           |          |           |            |
| <b>Short-term investments</b> |                                    |           |          |           |            |
| Fixed rate amounts            | \$ 15,928                          | \$ 27,173 |          | \$ 43,101 | \$ 43,130  |
| Weighted-average rate         | 0.54%                              | 2.31%     |          |           |            |
| Variable rate amounts         | \$ 3,213                           |           |          | \$ 3,213  | \$ 3,214   |
| Weighted-average rate         | 1.22%                              |           |          |           |            |
| <b>Long-term investments</b>  |                                    |           |          |           |            |
| Fixed rate amounts            |                                    | \$ 10,807 | \$ 8,937 | \$ 19,744 | \$ 19,701  |
| Weighted-average rate         |                                    | 1.54%     | 2.87%    |           |            |
| Total investment portfolio    | \$ 35,980                          | \$ 37,980 | \$ 8,937 | \$ 82,897 | \$ 82,883  |

*Foreign exchange risk.* From time to time, Intevac enters into foreign currency forward exchange contracts to hedge certain of its anticipated foreign currency re-measurement exposures. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on Intevac's operating results. The notional amount of Company's foreign currency derivatives was \$1.9 million at June 29, 2013.

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

Intevac maintains a set of disclosure controls and procedures that are designed to ensure that information relating to Intevac, Inc. required to be disclosed in periodic filings under the Securities Exchange Act of 1934, or Exchange Act, is recorded, processed, summarized and reported in a timely manner under the Exchange Act. In connection with the filing of this Form 10-Q for the quarter ended June 29, 2013, as required under Rule 13a-15(b) of the Exchange Act, an evaluation was carried out under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Intevac's disclosure

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controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, Intevac's Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 29, 2013.

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

### **Definition of disclosure controls**

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

### **Limitations on the effectiveness of controls**

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

### **Changes in internal controls over financial reporting**

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

## **PART II. OTHER INFORMATION**

### **Item 1. *Legal Proceedings***

From time to time, Intevac is involved in claims and legal proceedings that arise in the ordinary course of business. Intevac expects that the number and significance of these matters will increase as Intevac's business expands. Any claims or proceedings against us, whether meritorious or not, could be time consuming, result in costly litigation, 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.

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**Item 1A. Risk Factors**

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

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

The majority of our revenue is derived from the sale of equipment used to manufacture commodity technology products such as disk drives and PV solar cells. This subjects us to business cycles, the timing, length and volatility of which can be difficult to predict. When demand for commodity technology products exceeds production capacity, then demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of commodity technology products exceeds demand, then demand for new capital equipment such as ours tends to be depressed. For example, sales of systems for magnetic disk production were depressed from late 2007 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 and 2012, 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. For example, while we previously believed that our sales would continue to be depressed through 2012, we now believe that the cycle will continue through at least 2013.

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

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

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

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

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

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

Our 200 Lean customers also experience competition from companies that produce alternative storage technologies like flash memory, which offer smaller size, lower power consumption and more rugged designs. These storage technologies are being used increasingly in enterprise applications and smaller form factors such as tablets, smart-phones, ultra-books, notebook personal computers instead of hard disk drives. Tablet computing devices and smart-phones 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 primarily from Canon Anelva, which has sold a substantial number of systems worldwide. In the PV equipment market, Intevac faces competition from large established competitors including Applied Materials, Centrotherm Photovoltaics, Amtech, Jusung and Von Ardenne. In the market for our military imaging products we experience competition from companies such as ITT Exelis and L-3 Communications. 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.

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 system, our LEAN SOLAR systems for PV applications, our digital night-vision 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. To date we have not recognized



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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 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.

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***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, Singapore 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.

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Intevac has benefitted from a tax holiday in Singapore which is scheduled to expire at the end of 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 are presently in discussion with the Singapore tax authority to terminate this tax holiday effective January 1, 2013 due to current conditions in the hard disk drive business, which will not allow Intevac to be able to meet the conditions required to continue benefitting from the tax holiday. We expect the Singapore tax authorities to issue the terms and conditions allowing us to terminate the tax holiday early during the third quarter of 2013. The terms and conditions could include a claw back by the Singapore government of tax benefits received in previous years. A claw back 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 believed we would generate taxable income. In 2012, the Company established a \$23.4 million non-cash valuation allowance against certain of its U.S. deferred tax assets based upon an evaluation of all available objectively verifiable evidence, including but not limited to the cumulative loss incurred over the three-year period ended December 31, 2012 by the Company's U.S. operations. The establishment of the non-cash valuation allowance on the Company's U.S. deferred tax assets did not have any impact on its cash, nor does such an allowance preclude the Company from utilizing its tax losses, tax credits or other deferred tax assets in future periods.

Intevac will need to generate approximately \$51.4 million of taxable income in Singapore in order to fully realize the foreign deferred tax assets recorded as of June 29, 2013. If our expectations of future income are incorrect, we could be required to establish additional valuation allowance against some or the entire remaining deferred tax assets which are primarily attributable to our Singapore operation.

***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 and Singapore and international customer support offices in Singapore, China, and Malaysia. We expect that international sales will continue to account for a significant portion of our total revenue in future years. Certain of our suppliers are also located outside the United States.

Managing our global operations presents challenges including, but not limited to, those arising from: (1) global trade issues; (2) variations in protection of intellectual property and other legal rights in different countries; (3) concerns of U.S. governmental agencies regarding possible national commercial and/or security issues posed by growing manufacturing business in Asia; (4) fluctuation of interest rates, raw material costs, labor and 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 intangible assets and had significant goodwill on our balance sheet. We test these 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 intangible assets for impairment include: a significant reduction in our stock price, and as a result market

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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 2012, as a result of a decline in our market capitalization and a reduction in our revenue expectations we recorded a goodwill impairment charge in the amount of \$18.4 million. We will continue to evaluate the carrying value of our intangible assets and if we determine in the future that there is a potential further impairment, we may be required to record additional charges to earnings which could materially adversely affect our financial results and could also materially adversely affect our business. See Note 4 Purchased Intangible Assets in the Notes to the Condensed Consolidated Financial Statements for additional information related to impairment of 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.

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

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

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

We have completed a number of acquisitions during our operating history. For example, in 2007, we acquired certain assets of DeltaNu, LLC and certain assets of Creative Display Systems, LLC, in 2008 we acquired certain assets of OC Oerlikon Balzers Ltd., in 2010 we acquired the outstanding shares of SIT, in 2012 we completed the sale of certain semiconductor mainframe technology assets and in 2013 we completed the sale of the assets of DeltaNu. 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 are subject to risks of non-compliance with environmental and other governmental 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, remediation costs 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.

We are also subject to a variety of other governmental regulations and may incur significant costs associated with the compliance with these regulations. For example rules adopted by the SEC to implement the Dodd-Frank Wall Street Reform and Consumer Protection Act impose diligence and disclosure requirements regarding the use of conflict minerals mined from the Democratic Republic of Congo and adjoining countries in the products we manufacture. Compliance with these regulations is likely to result in additional costs and expenses or may affect the sourcing and availability of the components used in the products we manufacture.

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

Our operations are vulnerable to interruption by fire, earthquake, floods or other natural disaster, quarantines or other disruptions associated with infectious diseases, national catastrophe, terrorist activities, war, disruptions in our computing and communications infrastructure due to power loss, telecommunications failure, human error, physical or electronic security breaches and computer viruses, and other events beyond our control. We do not have a detailed disaster recovery plan. Despite our implementation of network security measures, our tools and servers may be vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems and tools located at customer sites. Political instability could cause us to incur increased costs in transportation, make such transportation unreliable, increase our insurance costs or cause international currency markets to fluctuate. All these unforeseen disruptions and instabilities could have the same effects on our suppliers and their ability to timely deliver their products. In addition, we do not carry sufficient business interruption insurance to compensate us for all losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business and results of operations. For example, we self-insure earthquake risks

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because we believe this is the prudent financial decision based on the high cost of the limited coverage available in the earthquake insurance market. An earthquake could significantly disrupt our operations, most of which are conducted in California. It could also significantly delay our research and engineering effort on new products, most of which is also conducted in California. We take steps to minimize the damage that would be caused by business interruptions, but there is no certainty that our efforts will prove successful.

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

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

We have completed the evaluation of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Although our assessment, testing, and evaluation resulted in our conclusion that as of December 31, 2012, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. Ongoing compliance with this requirement is complex, costly and time-consuming. If Intevac fails to maintain effective internal control over financial reporting; our management does not timely assess the adequacy of such internal control; or our independent registered public accounting firm does not deliver an unqualified opinion as to the effectiveness of our internal control over financial reporting, then we could be subject to restatement of previously reported financial results, regulatory sanctions and a decline in the public's perception of Intevac, which could have a material and adverse effect on our business, financial condition and results of operations.

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

None.

**Item 3. Defaults upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

Not applicable.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

The following exhibits are filed herewith:

| Exhibit<br>Number | Description  |
|-------------------|--|
| 10.1              | The Registrant's 2003 Employee Stock Purchase Plan, as amended + |

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- 10.2 Offer Letter with Wendell Blonigan (1) +
- 10.3 Severance Agreement with Wendell Blonigan (1) +

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|---------|--|
| 31.1    | Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.  |
| 31.2    | Certification of Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1    | Certifications Pursuant to U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.  |
| 101.INS | XBRL Instance Document *   |
| 101.SCH | XBRL Taxonomy Extension Schema *   |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document *  |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document *   |
| 101.LAB | XBRL Taxonomy Extension Label Linkbase Document *  |
| 101.PRE | XBRL Taxonomy Extension Presentation Linkbase Document *   |

(1) Previously filed as an exhibit to the Company's Report on Form 8-K filed July 9, 2013.

+ Management compensatory plan or arrangement required to be filed as an exhibit.

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



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SIGNATURES

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

INTEVAC, INC.

Date: July 30, 2013

By: /s/ WENDELL BLONIGAN  
Wendell Blonigan  
President and Chief Executive Officer  
  
(Principal Executive Officer)

Date: July 30, 2013

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