

INTEVAC INC
Form 10-Q
May 03, 2016
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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 April 2, 2016

OR

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

For the transition period from _____ to _____

Commission file number 0-26946

INTEVAC, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3125814
(IRS Employer
Identification No.)

3560 Bassett Street
Santa Clara, California 95054

(Address of principal executive office, including Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer

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

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

On May 3, 2016, 20,649,857 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

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INTEVAC, INC.

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	April 2, 2016	January 2, 2016
	(Unaudited)	
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 21,800	\$ 13,746
Short-term investments	14,742	23,208
Trade and other accounts receivable, net of allowances of \$0 at both April 2, 2016 and at January 2, 2016	5,203	12,310
Inventories	20,368	18,760
Prepaid expenses and other current assets	1,599	1,712
Total current assets	63,712	69,736
Property, plant and equipment, net	12,208	11,921
Long-term investments	6,951	9,673
Restricted cash	1,780	1,780
Intangible assets, net of amortization of \$5,488 at April 2, 2016 and \$5,275 at January 2, 2016	2,899	3,112
Deferred income taxes and other long-term assets	1,471	1,459
Total assets	\$ 89,021	\$ 97,681
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 4,455	\$ 5,950
Accrued payroll and related liabilities	3,364	4,066
Other accrued liabilities	3,420	5,632
Customer advances	3,625	3,625
Total current liabilities	14,864	19,273
Other long-term liabilities	2,385	2,411
Stockholders' equity:		
Common stock, \$0.001 par value	21	20

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Additional paid-in capital	168,482	166,514
Treasury stock, 4,845 shares at April 2, 2016 and January 2, 2016	(28,489)	(28,489)
Accumulated other comprehensive income	523	412
Accumulated deficit	(68,765)	(62,460)
Total stockholders' equity	71,772	75,997
Total liabilities and stockholders' equity	\$ 89,021	\$ 97,681

Note: Amounts as of January 2, 2016 are derived from the January 2, 2016 audited consolidated financial statements.

See accompanying notes.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended	
	April 2,	April 4,
	2016	2015
	(Unaudited)	
	(In thousands, except per	
	share amounts)	
Net revenues:		
Systems and components	\$ 13,282	\$ 18,082
Technology development	382	1,803
Total net revenues	13,664	19,885
Cost of net revenues:		
Systems and components	8,950	11,585
Technology development	858	1,378
Total cost of net revenues	9,808	12,963
Gross profit	3,856	6,922
Operating expenses:		
Research and development	5,176	4,608
Selling, general and administrative	4,996	5,253
Total operating expenses	10,172	9,861
Loss from operations	(6,316)	(2,939)
Interest income and other, net	37	79
Loss before income taxes	(6,279)	(2,860)
Provision for income taxes	26	33
Net loss	\$ (6,305)	\$ (2,893)
Net loss per share:		
Basic and Diluted	\$ (0.31)	\$ (0.12)
Weighted average common shares outstanding:		
Basic and Diluted	20,551	23,229

See accompanying notes.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three months ended	
	April 2, 2016	April 4, 2015
	(Unaudited)	
	(In thousands)	
Net loss	\$ (6,305)	\$ (2,893)
Other comprehensive income, before tax:		
Change in unrealized net gain on available-for-sale investments	44	29
Foreign currency translation gains	67	
Other comprehensive income, before tax	111	29
Income tax provision related to items in other comprehensive income		
Other comprehensive income, net of tax	111	29
Comprehensive loss	\$ (6,194)	\$ (2,864)

See accompanying notes.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	April 2, 2016	April 4, 2015
	(Unaudited)	
	(In thousands)	
Operating activities		
Net loss	\$ (6,305)	\$ (2,893)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	1,176	1,173
Net amortization of investment premiums and discounts	36	131
Equity-based compensation	1,111	862
Change in the fair value of acquisition-related contingent consideration	16	(26)
Changes in operating assets and liabilities	1,296	(1,295)
Total adjustments	3,635	845
Net cash and cash equivalents used in operating activities	(2,670)	(2,048)
Investing activities		
Purchases of investments	(2,109)	(11,476)
Proceeds from sales and maturities of investments	13,305	12,000
Purchases of leasehold improvements and equipment	(1,250)	(918)
Net cash and cash equivalents provided by (used in) investing activities	9,946	(394)
Financing activities		
Proceeds from issuance of common stock	711	834
Common stock repurchases		(2,806)
Net cash and cash equivalents provided by (used in) financing activities	711	(1,972)
Effect of exchange rate changes on cash and cash equivalents	67	
Net increase (decrease) in cash and cash equivalents	8,054	(4,414)
Cash and cash equivalents at beginning of period	13,746	21,482
Cash and cash equivalents at end of period	\$ 21,800	\$ 17,068

See accompanying notes.

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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 January 2, 2016 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 January 2, 2016 (2015 Form 10-K). Intevac's results of operations for the three months ended April 2, 2016 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. Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-02, *Leases (Topic 842)*, which amends the existing guidance to require lessees to recognize lease assets and lease liabilities arising from operating leases in a classified balance sheet. The requirements of this ASU are effective for financial statements for annual periods and interim periods within those annual periods beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact that ASU 2016-02 will have on our consolidated financial statements.

In March 2016, the FASB issued ASU No. 2016-09, *Compensation - Stock Compensation (Topic 718)*. This ASU makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. ASU 2016-09 also clarifies the statement of cash flows presentation for certain components of share-based awards. The standard is effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. We are currently assessing how the adoption of this standard will impact our consolidated financial statements.

3. Inventories

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

	April 2, 2016	January 2, 2016
	(In thousands)	
Raw materials	\$ 10,547	\$ 11,081
Work-in-progress	8,168	4,365
Finished goods	1,653	3,314
	\$ 20,368	\$ 18,760

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

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

4. Equity-Based Compensation

At April 2, 2016, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan and the 2004 Equity Incentive Plan (the Plans) and the 2003 Employee Stock Purchase Plan (the ESPP). Intevac s stockholders approved all of these plans. The Plans permit the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, restricted stock units (RSUs), performance units and performance bonus awards.

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 entry date into 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.

Compensation Expense

The effect of recording equity-based compensation for the three-month periods ended April 2, 2016 and April 4, 2015 was as follows:

	Three Months Ended	
	April 2, 2016	April 4, 2015
	(In thousands)	
Equity-based compensation by type of award:		
Stock options	\$ 276	\$ 316
RSUs	634	340
Employee stock purchase plan	201	206
Total equity-based compensation	\$ 1,111	\$ 862

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.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Option activity as of April 2, 2016 and changes during the three months ended April 2, 2016 were as follows:

	Shares	Weighted Average Exercise Price
Options outstanding at January 2, 2016	2,433,647	\$ 7.52
Options granted	8,750	\$ 4.40
Options cancelled and forfeited	(19,503)	\$ 7.78
Options exercised		\$
Options outstanding at April 2, 2016	2,422,894	\$ 7.51
Vested and expected to vest at April 2, 2016	2,320,851	\$ 7.57
Options exercisable at April 2, 2016	1,435,063	\$ 8.53

Intevac issued 187,214 shares under the ESPP during the three months ended April 2, 2016.

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

	Three Months Ended	
	April 2, 2016	April 4, 2015
Stock Options:		
Weighted-average fair value of grants per share	\$ 1.50	\$ 2.60
Expected volatility	42.96%	49.62%
Risk free interest rate	1.04%	1.00%
Expected term of options (in years)	3.96	4.00
Dividend yield	None	None

Stock Purchase
Rights:

Upon consideration of the record, and the parties' memoranda and oral arguments, Brigade's Motion for Summary Judgment is allowed, and PIMCO's Motion for Summary Judgment is denied.

BACKGROUND

For purposes of summary judgment, the court will assume as true all undisputed facts supported by evidence in the record. Brigade Leveraged Capital Structures Fund Ltd. is a pooled investment fund organized under the laws of the Cayman Islands, and Brigade Capital Management, LLC, a Delaware limited liability company, manages it. Brown Decl., Ex. A at ¶ 5. The Funds are Massachusetts business trusts established by identical Declarations of Trust. Joint App. Ex. A, C. Each mutual fund is governed by its Fourth Amended and Restated Bylaws.¹ Joint App. Ex. B, D. Brigade holds 32.8% and 25.9% interests in the Funds, respectively. Joint App. Ex. E, F.

Each Fund's Declaration of Trust directs that "annual meetings of Shareholders . . . shall be held as specified in the Bylaws." Joint App. Ex. A at art. IV, § 1, Ex. C. at art. IV, § 1. Section 10.2 of each Fund's Bylaws provides that:

[R]egular meetings of the Shareholders for the election of Trustees and the transaction of such other business as may properly come before the meeting shall be held, so long as Common Shares are listed for trading on the New York Stock Exchange, on at least an annual basis on such day and at such place as shall be designated by the Trustees. . . . Written notice of any meeting of Shareholders, stating the date, time, place and purpose of the meeting, shall be given or caused to be given by a-majority of the Trustees and a majority of the Continuing Trustees at least seven days before such meeting to each Shareholder entitled to vote thereat. . . ."

¹ The Funds' fiscal year runs from August 1 to July 31. Brown Decl. Ex. D at ¶ 7.

Joint App. Ex. B at art. X, § 10.2, Ex. D at art. X, § 10.2. The Bylaws further provide that shareholders must receive at least seven days notice prior to the meeting. Joint App. Ex. B at art. X, § 10.6, Ex. D at art. X, § 10.6. Between 2005 and 2010, the Funds held their annual shareholder meetings jointly, between December 14 and December 18 of each year.² Joint App. Ex. G. The Funds' most recent annual shareholder meeting was held on December 14, 2010. Joint App. Ex. G.

On September 11, 2011, Brigade provided the Funds with written notice of Brigade's intention to nominate one of its partners, Neal P. Goldman, as a trustee of the Funds at their 2011 annual shareholder meeting. Joint App. Ex. I. On October 11, 2011, PIMCO issued a press release, announcing "that the Funds' annual Shareholder Meetings for the 2011-2012 fiscal year will be held jointly on Tuesday, July 31, 2012 at 10:30 A.M." The Funds last proxy statement, dated November 12, 2010, had stated that the meetings were anticipated to be held in December 2011. Joint App. Ex. J.

Brigade brought this action against PIMCO on December 1, 2011, seeking a declaratory judgment (Count I), and specific performance and injunctive relief (Count II). It contends that the Funds' postponement of their annual shareholder meeting to July 31, 2012, violates § 10.2 of each Fund's Bylaws, in that it creates a nineteen-month gap between shareholder meetings, and that it has been done to disenfranchise Brigade. Under Brigade's interpretation of § 10.2, annual shareholder meetings must be held within twelve months of each other, or, alternatively, must occur once each calendar year. In response, PIMCO asserts that § 10.2 of the Bylaws permits the Funds to hold annual shareholder meetings once every fiscal year. As the Funds' fiscal year ends on July 31, PIMCO argues that the annual shareholder meeting scheduled for July 31, 2012 meets the requirement of § 10.2, as it will be held prior to the end of FY 2012. Each party has now moved for summary judgment, contending that its interpretation of "annual" in § 10.2 is correct as a matter of law, and the interpretation of its opponent is incorrect as a matter of law.

DISCUSSION

Summary judgment is appropriate when “there is no genuine issue as to any material fact and . . . the moving party is entitled to judgment as a matter of law.” Mass. R. Civ. P. 56(c). As each party is moving for summary judgment, each party must satisfy the court that “the pleadings, depositions, answers to interrogatories, and admissions on file, together with the affidavits” support its position on § 10.2 of the Bylaws as a Matter of law. *Id.*; *Kourovacilis v. General Motors Corp.*, 410 Mass. 706, 711-13 (1991).

Each Fund’s Bylaws create a binding contract between itself and its shareholders, including Brigade. See *State Street Trust Co. v. Hall*, 311 Mass. 299, 306 (1942); *ER Holdings, Inc. v. Norton Co.*, 735 F.Supp. 1094, 1097 (D. Mass. 1990). The interpretation of unambiguous language of a contract is a question of law, appropriate for resolution on summary judgment. *Cabot Corp. v. AVX Corp.*, 448 Mass. 629, 640 (2007). This litigation is based on conflicting interpretations of the phrase “on at least an annual basis” in § 10.2 of the Funds’ Bylaws.

While Brigade asserts that “annual” connotes within one calendar year, PIMCO contends that it means within one fiscal year. Neither interpretation is persuasive. If the Bylaws permitted the funds to hold a meeting once every calendar year or every fiscal year, then the Funds could effectively disenfranchise its shareholders for extended periods by holding meetings 23 months apart. For example, the Funds could hold shareholder meetings in December, 2012, then January, 2013 (after providing shareholders with at least seven days notice), and then could hold their next meeting in December, 2014. This is permitted under the Bylaws if the use of “annual” means once per calendar year, as Brigade suggests. Similarly, PIMCO’s contention that “annual” means once per fiscal year would also lead to unfair results for shareholders.³ The court concludes that neither interpretation reflects the appropriate context and plain meaning of the Bylaws. See *General Convention of New Jerusalem in the U.S. of Am., Inc. v. MacKenzie*, 449 Mass. 832, 835 (2007) (“The words of a contract must be considered in the context of the entire contract rather than in isolation”).

2 PIMCO held its first annual shareholder meeting on November 16, 2004. Brown Decl. Ex. D. at119.

3 PIMCO could hold shareholder meetings in July, 2012, closely followed by one in August, 2012, under its interpretation of the Bylaws. The Funds' next shareholder meeting could be then held twenty-three months later, in July, 2014, under PIMCO's interpretation.

The court concludes that “on an annual basis” means that the shareholder meetings must occur within approximately twelve months of each other. The funds’ decision to delay the annual shareholder meeting to July 31, 2012 circumvents the purpose of the Bylaws, which is to provide a yearly voice to shareholders. Sound corporate governance principles require that the Funds enable their shareholders to approve or disapprove the Funds’ directions at “regular meetings of the Shareholders,” which should be held not less than every twelve months. Delaying the shareholder meeting deprives shareholders such as Brigade of that timely and essential voice. Holding an annual shareholder meeting nineteen months after the previous meeting violates § 10.2 of the Bylaws in that the meetings are not held “on an annual basis.” PIMCO’s other arguments also lack merit.⁴

Given the court’s interpretation of § 10.2 of the Funds’ Bylaws, PIMCO’s postponement of the shareholder meeting to July 31, 2012, violates the Funds’ Bylaws. PIMCO must, under those Bylaws, hold its shareholder meetings at some point in December of each year. Accordingly, the Funds shall, as soon as practicable, and in compliance with their Bylaws, set and then issue notice to their shareholders of the date of their next annual meeting.

ORDER

For the forgoing reasons, Plaintiffs’ Motion for Summary Judgment (Paper # 21) is ALLOWED, and Defendants’ Motion for Summary Judgment as to Counts I and II of Plaintiffs’ Verified Complaint (Paper # 23) is DENIED. The court hereby declares, adjudges and decrees that:

1. PIMCO Income Strategy Fund’s and PIMCO Income Strategy Fund II’s postponement of their annual shareholder meetings to July 31, 2012, violated § 10.2 of the Funds’ Bylaws;
2. PIMCO Income Strategy Fund and PIMCO Income Strategy Fund II shall schedule, notice, and hold the annual shareholder meeting for the year 2011 as soon as practicable after the date of this order,

consistent with the terms and requirements of the Bylaws; and

3. Section 10.2 of the Funds' Bylaws, as currently in effect, requires PIMCO Income Strategy Fund and PIMCO Income Strategy Fund II to schedule future annual shareholder meetings in or within twelve months of their last annual shareholder meetings.

SO ORDERED:

/s/ Peter M.
Lauriat
Peter M. Lauriat
Justice of the Superior Court

Dated: February 17, 2012

4 The court does not credit PIMCO's assertion that New York Stock Exchange Rule § 302.00 requires that annual shareholder meetings should be held once per fiscal year. The Funds were created under Massachusetts law. Their compliance with the rules of a private organization, of which they are voluntary members, is irrelevant to their obligations under their respective Declarations of Trust and Bylaws. Further, PIMCO's use of § 10.6(c) of the Bylaws is unavailing, as it refers specifically to the first annual shareholder meeting that occurred in November, 2004, and its second meeting thirteen months later in December, 2005.

Exhibit B

Neal P. Goldman Partner
399 Park Avenue 16th
Floor
New York, NY 10022
tel (212) 745-9700 fax
(212) 745-9701

February 29, 2012

Board of Trustees
PIMCO Income Strategy Fund ("PFL")
PIMCO Income Strategy Fund II ("PFN," and together
with PFL, the "Funds")
1633 Broadway
New York, NY 10019

Re: Brigade Leveraged Capital Structures Fund Ltd.
("Brigade LCSF") and Brigade Capital
Management, LLC ("Brigade CM," and together
with Brigade LCSF, "Brigade") v. PFL
and PFN (Civil Docket No.
SUCV2011-04361-BLS1)

Dear Trustee:

I am a Partner at Brigade CM. As you should be aware, Brigade is the second largest holder of preferred shares of each of the Funds. I have previously communicated with you and each of the other trustees of the Funds to address, among other things, our concerns regarding the performance, investment strategy and corporate governance policies and practices of the Funds.

As you are aware, on February 17, 2012, the Suffolk Superior Court for the Commonwealth of Massachusetts (the "Court") granted Brigade's motion for summary judgment and concluded that the joint 2011 annual meeting of shareholders of each of the Funds (the "2011 Annual Meeting") had been improperly delayed by over seven months in clear violation of the existing bylaws of each of the

Funds. The Court required that the Funds hold the 2011 Annual Meeting "as soon as practicable." A copy of the Court's order is attached for your reference. The bylaws of each of the Funds provide that a meeting of the trustees can be held on 24 hour notice. At this trustee meeting, it is practicable for the 2011 Annual Meeting to be set for the end of April 2012. Given the Court's decision, there is no basis for the trustees not to have already set the 2011 Annual Meeting in April 2012 consistent with the Court's order.

Unfortunately, on February 28, 2012, the Funds filed with the Court a notice of appeal and an emergency motion for a stay of the Court's order pending appeal. We are extremely disappointed with your decision to continue your effort to frustrate the rights of shareholders and postpone the 2011 Annual Meeting. We urge you to comply with the Court's order and to schedule and hold the 2011 Annual Meeting "as soon as practicable," which is by the end of April 2012.

While we are pleased that the Court struck down the board of trustees' unprecedented postponement of the 2011 Annual Meeting as a violation of the Funds' by-laws, we are not pleased that we had to expend considerable money, time, and effort to achieve that result and to undo an action that should never have been taken by you, as a fiduciary, in the first place. Indeed, despite our repeated requests, we have never received any explanation why the Funds took the extraordinary step of delaying the 2011 Annual Meeting to July 31, 2012. Rather, your action can only be viewed as a direct response to the intention of a major shareholder to seek one seat on the board of trustees.

Please be advised that we intend to hold each of the Fund's trustees liable to the fullest extent permitted under law for the conduct undertaken to date and we expect that you will now start to comply with the fiduciary duty that you owe to us and to all other shareholders of the Funds.

Sincerely,

/s/ Neal Goldman
Neal Goldman

Encl.

CC: Brian S. Shlissel
President and Chief Executive Officer
PIMCO Income Strategy Fund; PIMCO Income
Strategy Fund II

Exhibit C

Joint Filing Agreement

Pursuant to Rule 13d-1(k)(1) under the Securities Exchange Act of 1934, as amended, each of the undersigned hereby agrees that only one statement containing the information required by Schedule 13D need be filed with respect to the ownership by each of the undersigned of PIMCO Income Strategy Fund.

This Agreement may be executed in any number of counterparts, each of which shall be deemed an original.

February 29, 2012
(Date)

Brigade Leveraged
Capital Structures
Fund Ltd.

/s/ Donald E.
Morgan, III
(Signature)

Director
(Name/Title)

Brigade Capital
Management, LLC

By: /s/ Donald E.
Morgan, III
(Signature)

Managing Member
(Name/Title)

/s/ Donald E.
Morgan, III
(Signature)

