

INTEVAC INC  
Form 10-Q  
October 27, 2009

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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 September 26, 2009**

**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

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

**APPLICABLE ONLY TO CORPORATE ISSUERS:**

On October 27, 2009, 22,067,084 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

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

	<b>September 26, 2009</b>	<b>December 31, 2008</b>
	<b>(Unaudited)</b>	
	<b>(In thousands)</b>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 19,769	\$ 39,201
Short-term investments	11,997	
Trade and other accounts receivable, net of allowances of \$33 at September 26, 2009 and \$145 at December 31, 2008	12,313	15,014
Inventories	22,792	17,674
Prepaid expenses and other current assets	5,498	4,806
Deferred income tax assets	3,356	3,204
Total current assets	75,725	79,899
Property, plant and equipment, net	13,290	14,886
Long-term investments	65,973	66,328
Goodwill	7,905	7,905
Other intangible assets, net of amortization of \$1,108 at September 26, 2009 and \$693 at December 31, 2008	3,660	4,054
Deferred income taxes and other long-term assets	20,137	16,097
Total assets	\$ 186,690	\$ 189,169
 <b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities:		
Note payable	\$	\$ 2,000
Accounts payable	5,203	4,214
Accrued payroll and related liabilities	3,176	3,395
Other accrued liabilities	4,191	3,175
Customer advances	5,745	2,807
Total current liabilities	18,315	15,591
Other long-term liabilities	203	509
Stockholders' equity:		
Common stock, \$0.001 par value	22	22
Additional paid-in capital	133,382	128,686
Accumulated other comprehensive loss	(2,349)	(4,808)
Retained earnings	37,117	49,169
Total stockholders' equity	168,172	173,069

Total liabilities and stockholders' equity	\$ 186,690	\$ 189,169
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Note: Amounts as of December 31, 2008 are derived from the December 31, 2008 audited consolidated financial statements.

See accompanying notes to the condensed consolidated financial statements.

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>26,</b>	<b>27,</b>	<b>26,</b>	<b>27,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	(Unaudited)			
	(In thousands, except per share amounts)			
Net revenues:				
Systems and components	\$ 14,619	\$ 25,263	\$ 32,277	\$ 82,403
Technology development	4,536	3,297	11,504	11,464
Total net revenues	19,155	28,560	43,781	93,867
Cost of net revenues:				
Systems and components	8,154	17,687	19,969	49,674
Technology development	2,323	1,788	6,356	6,664
Total cost of net revenues	10,477	19,475	26,325	56,338
Gross profit	8,678	9,085	17,456	37,529
Operating expenses:				
Research and development	6,840	8,620	22,255	26,426
Selling, general and administrative	5,551	7,341	16,654	21,818
Total operating expenses	12,391	15,961	38,909	48,244
Loss from operations	(3,713)	(6,876)	(21,453)	(10,715)
Interest income and other, net	122	884	780	3,101
Loss before income taxes	(3,591)	(5,992)	(20,673)	(7,614)
Income tax benefit	1,799	2,639	8,621	4,887
Net loss	\$ (1,792)	\$ (3,353)	\$ (12,052)	\$ (2,727)
Net loss per share:				
Basic	\$ (0.08)	\$ (0.15)	\$ (0.55)	\$ (0.13)
Diluted	\$ (0.08)	\$ (0.15)	\$ (0.55)	\$ (0.13)
Weighted average common shares outstanding:				
Basic	22,014	21,761	21,942	21,700
Diluted	22,014	21,761	21,942	21,700

See accompanying notes to the condensed consolidated financial statements.

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

	Nine months ended	
	September 26, 2009	September 27, 2008
	(Unaudited)	
	(In thousands)	
<b>Operating activities</b>		
Net loss	\$ (12,052)	\$ (2,727)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	4,016	3,734
Equity-based compensation	3,709	5,004
Deferred income taxes	(4,267)	(4,514)
Changes in operating assets and liabilities	86	(7,498)
Total adjustments	3,544	(3,274)
Net cash and cash equivalents used in operating activities	(8,508)	(6,001)
<b>Investing activities</b>		
Purchases of investments	(20,980)	(7,000)
Proceeds from maturities of investments	13,000	42,650
Acquisition of Oerlikon assets, net of cash acquired		(15,093)
Purchases of leasehold improvements and equipment	(2,009)	(3,142)
Net cash and cash equivalents provided by (used in) investing activities	(9,989)	17,415
<b>Financing activities</b>		
Net proceeds from issuance of common stock	1,021	1,803
Repayment of note payable	(2,000)	(2,000)
Net cash and cash equivalents used in financing activities	(979)	(197)
Effect of exchange rate changes on cash	44	(65)
Net increase (decrease) in cash and cash equivalents	(19,432)	11,152
Cash and cash equivalents at beginning of period	39,201	27,673
Cash and cash equivalents at end of period	\$ 19,769	\$ 38,825

See accompanying notes to the condensed consolidated financial statements.

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

**1. Basis of Presentation and Significant Accounting Policies**

***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, 2008 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, 2008 (2008 Form 10-K). Intevac's results of operations for the three and nine months ended September 26, 2009 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. Subsequent events have been evaluated through October 27, 2009, the date these financial statements were issued.

There have been no material changes in Intevac's significant accounting policies, as compared to the significant accounting policies described in the 2008 Form 10-K, except that the Company has updated its disclosures related to the following policies:

***Revenue Recognition***

Intevac recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have passed to Intevac's customer or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Intevac's shipping terms are customarily FOB shipping point or equivalent terms. Intevac's revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment, Intevac recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred based on the estimated fair value, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer acceptance; and (3) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred at estimated fair value until delivery of the deferred elements. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements usually split between delivery of the parts and installation on the customer's systems. In these cases, Intevac recognizes revenue for the fair market value of the parts upon shipment and transfer of title, and recognizes revenue for the fair market value of installation services when those services are completed. Revenue related to sales of spare parts is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services.

Intevac performs research and development work under various government-sponsored research contracts. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. Intevac considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on fixed-price contracts is recognized using the percentage-of-completion method of contract accounting. Intevac determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. When estimates of total costs to be incurred on a contract exceed total estimates of revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.



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

***Goodwill and Purchased Intangible Assets***

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

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

**2. New Accounting Pronouncements**

In January 2009, the Securities and Exchange Commission issued Release No. 33-9002, *Interactive Data to Improve Financial Reporting*. The final rule requires companies to provide their financial statements and financial statement schedules to the Securities and Exchange Commission and on their corporate websites in interactive data format using the eXtensible Business Reporting Language (XBRL). The rule was adopted by the Securities and Exchange Commission to improve the ability of financial statement users to access and analyze financial data. The Securities and Exchange Commission adopted a phase-in schedule indicating when registrants must furnish interactive data. Under this schedule, Intevac will be required to submit filings with financial statement information using XBRL commencing with its March 26, 2011 quarterly report on Form 10-Q. Intevac is currently evaluating the impact of XBRL reporting on its financial reporting process.

In April 2009, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) FAS 141R-1 *Accounting for Assets Acquired and Liabilities Assumed in a Business Combination That Arise from Contingencies* (Codified within Accounting Standards Codification ASC 805) (FSP FAS 141R-1). This FSP amends and clarifies Statement of Financial Accounting Standards (SFAS) No. 141 (revised 2007), *Business Combinations* (Codified within ASC 805) (SFAS 141R), to require that an acquirer recognize at fair value, at the acquisition date, an asset acquired or a liability assumed in a business combination that arises from a contingency if the acquisition-date fair value of that asset or liability can be determined during the measurement period. If the acquisition-date fair value of such an asset acquired or liability assumed cannot be determined, the acquirer should apply the provisions of SFAS 5,

Accounting for Contingencies , to determine whether the contingency should be recognized at

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

the acquisition date or after it. FSP FAS 141R-1 is effective for assets or liabilities arising from contingencies in business combinations for which the acquisition date is after the beginning of the first annual reporting period beginning after December 15, 2008. Intevac expects FSP FAS 141-R may have an impact on Intevac's financial position and results of operations in future periods, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the acquisitions Intevac consummates in the future.

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (not yet included in the Codification) (SFAS 167), which modifies how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. SFAS 167 clarifies that the determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's power to direct the activities of the entity that most significantly impact the entity's economic performance. SFAS 167 requires an ongoing reassessment of whether a company is the primary beneficiary of a variable interest entity. SFAS 167 also requires additional disclosures about a company's involvement in variable interest entities and any significant changes in risk exposure due to that involvement. SFAS 167 is effective for fiscal years beginning after November 15, 2009 and is effective for Intevac on January 1, 2010. Intevac expects SFAS 167 may have an impact on Intevac's financial position and results of operations in future periods, but the nature and magnitude of the specific effects will depend upon the nature, terms and size of the transactions Intevac consummates in the future.

In August 2009, the FASB issued Accounting Standards Update (ASU) 2009-05, Measuring Liabilities at Fair Value, which clarifies how entities should estimate the fair value of liabilities under ASC 820, Fair Value Measurements and Disclosures (formerly FASB Statement 157). ASU 2009-05 is effective for the first interim or annual reporting period beginning after August 28, 2009 and is effective for Intevac on September 27, 2009. Although Intevac will continue to evaluate the application of SFAS 157 and this update for its non-financial liabilities, Intevac does not expect the implementation of ASU 2009-05 will have a material effect on its consolidated financial statements.

In October 2009, the FASB issued ASU 2009-13, Multiple-Deliverable Revenue Arrangements, (amendments to FASB ASC Topic 605, Revenue Recognition) (ASU 2009-13) and ASU 2009-14, Certain Arrangements That Include Software Elements, (amendments to FASB ASC Topic 985, Software) (ASU 2009-14). ASU 2009-13 requires entities to allocate revenue in an arrangement using estimated selling prices of the delivered goods and services based on a selling price hierarchy. The amendments eliminate the residual method of revenue allocation and require revenue to be allocated using the relative selling price method. ASU 2009-14 removes tangible products from the scope of software revenue guidance and provides guidance on determining whether software deliverables in an arrangement that includes a tangible product are covered by the scope of the software revenue guidance. ASU 2009-13 and ASU 2009-14 should be applied on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010, with early adoption permitted. The Company is currently evaluating the impact that adoption of these pronouncements will have on its consolidated financial statements.

**3. Inventories**

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

	<b>September 26, 2009</b>	<b>December 31, 2008</b>
	<b>(In thousands)</b>	
Raw materials	\$ 12,137	\$ 10,470
Work-in-progress	9,000	4,932
Finished goods	1,655	2,272

\$ 22,792      \$    17,674

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

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

Inventory reserves included in the above amounts were \$10.4 million and \$9.1 million at September 26, 2009 and December 31, 2008, respectively.

**4. Equity-Based Compensation**

At September 26, 2009, Intevac had equity-based awards outstanding under the 2004 Equity Incentive Plan (the 2004 Plan ) and the 2003 Employee Stock Purchase Plan (the ESPP ). Intevac s stockholders approved both of these plans.

The 2004 Plan permits the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. During the three months ended September 26, 2009, Intevac granted 8,500 stock options with an estimated total grant-date fair value of \$56,000. Of this amount, estimated awards of \$13,000 are not expected to vest. During the nine months ended September 26, 2009, Intevac granted 531,000 stock options with an estimated total grant-date fair value of \$1.3 million. Of this amount, estimated awards of \$275,000 are not expected to vest.

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

**Compensation Expense**

The effect of recording equity-based compensation for the three and nine-month periods ended September 26, 2009 and September 27, 2008 was as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>26,</b>	<b>27,</b>	<b>26,</b>	<b>27,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<i>(in thousands, except per share amounts)</i>			
Equity-based compensation by type of award:				
Stock options	\$ 834	\$ 1,311	\$ 3,051	\$ 3,960
Employee stock purchase plan	174	478	624	978
Amounts (capitalized as inventory) released to cost of sales	(9)	(23)	34	66
Total equity-based compensation	999	1,766	3,709	5,004
Tax effect on equity-based compensation	(291)	(512)	(1,077)	(1,499)
Net effect on net loss	\$ 708	\$ 1,254	\$ 2,632	\$ 3,505

**Valuation Assumptions**

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



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

The weighted-average estimated values of employee stock options granted during the three months ended September 26, 2009 and September 27, 2008 were \$6.55 per share and \$6.04 per share, respectively. The weighted-average estimated values of employee stock options granted during the nine months ended September 26, 2009 and September 27, 2008 were \$2.53 per share and \$6.27 per share, respectively. The weighted-average estimated fair values of employee stock purchase rights granted pursuant to the ESPP during the three months ended September 26, 2009 and September 27, 2008 were \$5.45 and \$5.20 per share, respectively. The weighted-average estimated fair values of employee stock purchase rights granted pursuant to the ESPP during the nine months ended September 26, 2009 and September 27, 2008 were \$2.73 and \$5.40 per share, respectively. The fair value of each option and employee stock purchase right grant is estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 26, 2009</b>	<b>September 27, 2008</b>	<b>September 26, 2009</b>	<b>September 27, 2008</b>
Stock Options:				
Expected volatility	67.84%	65.54%	67.16%	65.40%
Risk free interest rate	2.14%	2.89%	2.00%	2.94%
Expected term of options (in years)	4.58	4.48	4.47	4.46
Dividend yield	None	None	None	None

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 26, 2009</b>	<b>September 27, 2008</b>	<b>September 26, 2009</b>	<b>September 27, 2008</b>
Stock Purchase Rights:				
Expected volatility	85.39%	64.22%	82.56%	62.65%
Risk free interest rate	0.45%	1.90%	0.85%	1.68%
Expected term of purchase rights (in years)	1.00	1.92	1.85	1.87
Dividend yield	None	None	None	None

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

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

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

On July 14, 2008, Intevac acquired certain assets and liabilities of OC Oerlikon Balzers Ltd. ( Oerlikon )'s magnetic media equipment business for a purchase price of \$15.1 million in cash, net of cash acquired. In addition Intevac

agreed to pay contingent consideration to Oerlikon in the form of a royalty on Intevac's net revenue from commercial sales of certain products. This royalty agreement terminates on July 13, 2011. Intevac has made no



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

payments to Oerlikon under this agreement through September 26, 2009. As part of the acquisition, Intevac also entered into a settlement agreement with Oerlikon related to a patent infringement lawsuit filed by Intevac against Unaxis USA, Inc., a wholly owned subsidiary of Oerlikon, and all claims in the litigation were dismissed.

In connection with this acquisition, Intevac recorded goodwill of \$9.8 million and intangible assets of \$3.8 million. Of the \$3.8 million of acquired intangible assets, \$2.6 million was assigned to customer relationships (being amortized over 6 to 9 years), \$1.2 million was assigned to purchased technology (being amortized over 3 to 7 years) and \$80,000 was assigned to acquired backlog (which was amortized over 1 year). Future contingent payments will also be allocated to goodwill.

The results of operations for the acquired business have been included in Intevac's consolidated statements of operations for the periods subsequent to the acquisition date. Pro forma results of operations have not been presented because the effects of the acquisition were not material.

Goodwill and indefinite-life intangible assets are tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill and unamortized intangible assets may be impaired. In the fourth quarter of fiscal 2008, Intevac performed an interim goodwill impairment analysis. The analysis indicated that there would be no remaining implied value attributable to goodwill in the Equipment reporting unit and accordingly, Intevac wrote off all \$9.7 million of goodwill in its Equipment reporting unit. The goodwill associated with the Intevac Photonics reporting unit was not impaired. Intevac did not record any impairment of goodwill and intangible assets during the nine months ended September 26, 2009. At September 26, 2009, Intevac had a total of \$7.9 million of goodwill and \$120,000 of indefinite-life intangible assets. At September 26, 2009 all goodwill is attributed to the Intevac Photonics segment.

Total amortization expense of purchased intangibles for the three months and nine months ended September 26, 2009 was \$138,000 and \$415,000, respectively. As of September 26, 2009, future amortization expense is expected to be \$139,000 for the remainder of 2009, \$552,000 for 2010, \$541,000 for 2011, \$541,000 for 2012, \$541,000 for 2013 and \$1.2 million thereafter. Intangible assets by segment are as follows: Equipment: \$2.5 million and Intevac Photonics: \$1.1 million.

## **6. Warranty**

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

On the 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.

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

The following table displays the activity in the warranty provision account, including estimated provisions for retrofit costs, for the three- and nine-month periods ending September 26, 2009 and September 27, 2008:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>26,</b>	<b>27,</b>	<b>26,</b>	<b>27,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>			
Beginning balance	\$ 1,183	\$ 2,136	\$ 1,695	\$ 3,092
Expenditures incurred under warranties	(310)	(842)	(1,070)	(2,053)
Accruals for product warranties issued during the reporting period	588	409	1,037	1,199
Acquired in a business combination		85		85
Adjustments to previously existing warranty accruals	46	121	(155)	(414)
Ending balance	\$ 1,507	\$ 1,909	\$ 1,507	\$ 1,909

The following table displays the balance sheet classification of the warranty provision account in the Condensed Consolidated balance sheet at:

	<b>September</b>	<b>December 31,</b>
	<b>26,</b>	<b>2008</b>
	<b>2009</b>	<b>2008</b>
	<b>(In thousands)</b>	
Other accrued liabilities	\$ 1,479	\$ 1,286
Other long-term liabilities	28	409
Total warranty provision	\$ 1,507	\$ 1,695

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

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

***Other Indemnifications***

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

indemnifications have been immaterial.

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

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

Cash and cash equivalents are comprised of short-term, highly liquid investments with original maturities of 90 days or less from the date of purchase. Investments are comprised of both available-for-sale securities, which are recorded at estimated fair value, and held-to-maturity securities, which are carried at amortized cost. Unrealized gains and losses associated with Intevac's available-for-sale investments, if any, are reported in stockholders' equity. Included in accounts payable are \$1.1 million and \$916,000 of book overdraft at September 26, 2009 and December 31, 2008, respectively.

The table below presents the estimated fair value or amortized principal amount and major security type for Intevac's investments:

	September 26, 2009	December 31, 2008
	(in thousands)	
Carrying value:		
Short-term investments-U.S. treasury bills	\$ 11,997	\$
Long-term investments-Auction rate securities	65,973	66,328
Total investments in debt securities	\$ 77,970	\$ 66,328
Approximate fair value of investments in debt securities	\$ 77,972	\$ 66,328

As of September 26, 2009, financial assets measured utilizing Level 1 inputs were valued based on quoted market prices in active markets for identical securities and included money market funds in the amount of \$9.4 million and U.S. Treasury Bills in the amount of \$12.0 million.

As of September 26, 2009, Intevac's investment portfolio included \$70.4 million par value in auction rate securities (ARS). All of the ARS are student loan structured issues, where the loans have been originated under the U.S. Department of Education's Federal Family Education Loan Program. The principal and interest are 97-98% reinsured by the U.S. Department of Education and the collateral ratios range from 102% to 115%. Securities with a par value of \$57.7 million are rated AAA/Aaa, securities with a par value of \$9.7 million are rated AAA/A3 and a security with a par value of \$3.0 million is rated AAA/Baa3. These investments have experienced failed auctions beginning in February 2008. The investments in ARS will not be accessible until a successful auction occurs, they are restructured into a more liquid security, a buyer is found outside of the auction process, or the underlying securities have matured.

As of September 26, 2009, there was insufficient observable market information for the ARS held by Intevac to determine the fair value. Therefore Level 3 fair values were estimated for these securities by incorporating assumptions that market participants would use in their estimates of fair value. At September 26, 2009, the fair value of the ARS was estimated at \$66.0 million based on a valuation by Houlihan Smith & Company, Inc. using discounted cash flow models and management applying internal analysis to the valuation. The estimates of future cash flows are based on certain key assumptions, such as discount rates appropriate for the type of asset and risk, which are significant unobservable inputs. Some of these assumptions included credit quality, collateralization, final stated maturity, estimates of the probability of being called or becoming liquid prior to final maturity, redemptions of similar ARS, previous market activity for the same investment security, impact due to extended periods of maximum auction rates and valuation models. These securities are classified as long-term assets, as management believes that the ARS market will not become liquid within the next year. Potentially, it could take until the final maturity of the underlying notes (ranging from 23 years to 39 years) to realize these investments' recorded values.



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

Management believes that the impairment of the ARS investments is temporary, primarily due to the government guarantee of the underlying securities and Intevac's ability to hold these securities for the foreseeable future. Management believes that it is more likely than not that it would not be required to sell these securities before the recovery of their par amounts. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders' equity. Such an unrealized loss does not reduce net income for the applicable accounting period, because the loss is not viewed as other-than-temporary. The factors evaluated to differentiate between temporary and other-than-temporary include the projected future cash flows, credit ratings actions, and assessment of the credit quality of the underlying collateral. Factors considered in determining whether a loss is temporary include length of time and the extent to which the investment's fair value has been less than the cost basis, the financial condition and near-term prospects of the issuer, including any specific events which may influence the operations of the issuer, and Intevac's intent and ability to retain the investment for a period of time sufficient to allow for any anticipated recovery of fair value. As of September 26, 2009, management has no reason to believe that any of the underlying issuers of Intevac's ARS or their insurers are presently at risk or that the underlying credit quality of the assets backing Intevac's ARS has been impacted by the reduced liquidity of these investments. As of September 26, 2009, based on the Level 3 valuation performed, Intevac determined that there was a temporary decline in fair value of its ARS of \$4.4 million.

On March 19, 2009, Intevac filed a statement of claim under the Financial Industry Regulatory Authority dispute resolution process against Citigroup Inc. and Citigroup Global Markets, Inc. (collectively, Citigroup) with respect to alleged fraud and market manipulation by Citigroup related to ARS. The statement of claim requests that Citigroup accept Intevac's tender of its ARS at par value and that Intevac receive compensatory, consequential and punitive damages and costs and expenses. Citigroup responded denying Intevac's claims. Intevac is currently in the discovery stage of this matter. An arbitration date of May 13, 2010 has been agreed upon for commencement of the arbitration of this dispute. As of September 26, 2009, the total par amount of ARS held by Intevac which are subject to the Citigroup claim amounted to \$56.1 million.

The following table presents the changes in Level 3 instruments measured on a recurring basis for the three and nine months ended September 26, 2009 and September 27, 2008. Investments in ARS are Intevac's only Level 3 instruments and are classified as available-for-sale with changes in fair value recorded in equity. Changes in Level 3 instruments (in thousands):

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 26, 2009</b>	<b>September 27, 2008</b>	<b>September 26, 2009</b>	<b>September 27, 2008</b>
	<b>(in thousands)</b>			
Beginning balance	\$ 66,187	\$ 76,195	\$ 66,328	\$ 81,450
Net unrealized gains and losses included in other comprehensive loss	286	63	3,645	(1,492)
Purchases and settlements, net	(500)	(3,150)	(4,000)	(6,850)
Ending balance	\$ 65,973	\$ 73,108	\$ 65,973	\$ 73,108
Net change in unrealized gains and losses	\$ 286	\$ 63	\$ 3,645	\$ (1,492)

**9. Borrowing Facility**

On March 5, 2008, Intevac entered into an agreement with Citigroup for a secured revolving loan facility. This loan facility may be terminated at the discretion of Citigroup and amounts outstanding are payable on demand. It is secured by Intevac's ARS held at Citigroup. Approximately \$18.5 million of credit is currently available pursuant to the loan facility. The interest rate on the loan facility is prime minus 1.5 percent. No amounts were outstanding under this credit facility at September 26, 2009.

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

**10. Other Comprehensive Loss**

The components of accumulated other comprehensive loss, at September 26, 2009 and December 31, 2008 were as follows:

	<b>September 26, 2009</b>	<b>December 31, 2008</b>
	<b>(in thousands)</b>	
Accumulated net unrealized holding loss on available-for-sale investments, net of tax	\$ (2,877)	\$ (5,247)
Foreign currency translation gains	528	439
Total accumulated other comprehensive loss	\$ (2,349)	\$ (4,808)

The changes in the components of comprehensive loss for the three and nine month periods ended September 26, 2009 and September 27, 2008 were as follows:

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September 26, 2009</b>	<b>September 27, 2008</b>	<b>September 26, 2009</b>	<b>September 27, 2008</b>
	<b>(in thousands)</b>			
Net loss	\$ (1,792)	\$ (3,353)	\$ (12,052)	\$ (2,727)
Unrealized holding gains (losses) on available-for-sale investments, net of taxes:				
Increase (decrease) in unrealized holding gains (losses)	286	63	3,645	(1,492)
Income tax expense	(100)		(1,275)	
	186	63	2,370	(1,492)
Foreign currency translation gains (losses)	237	(438)	89	(77)
Total comprehensive loss	\$ (1,369)	\$ (3,728)	\$ (9,593)	\$ (4,296)



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

**11. Net Loss Per Share**

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

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>26,</b>	<b>27,</b>	<b>26,</b>	<b>27,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>			
Numerator:				
Numerator for diluted loss per share (loss) available to common stockholders	\$ (1,792)	\$ (3,353)	\$ (12,052)	\$ (2,727)
Denominator:				
Denominator for basic loss per share weighted-average shares	22,014	21,761	21,942	21,700
Effect of dilutive securities:				
Employee stock options (1)				
Dilutive potential common shares				
Denominator for diluted loss per share adjusted weighted-average shares and assumed conversions	22,014	21,761	21,942	21,700

(1) Potentially dilutive securities, consisting of shares issuable upon exercise of employee stock options, are excluded from the calculation of diluted EPS when their effect would be anti-dilutive. The weighted average number of employee stock options excluded for the

three-month periods ended September 26, 2009 and September 27, 2008 was 3,261,639 and 2,886,011, respectively, and the number of employee stock options excluded for the nine-month periods ended September 26, 2009 and September 27, 2008 was 2,361,456 and 2,679,915, respectively.

## **12. Segment Reporting**

Intevac's two reportable segments are: Equipment and Intevac Photonics, formerly Imaging Instrumentation. Intevac's chief operating decision-maker has been identified as the President and CEO, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon Intevac's management organization structure as of September 26, 2009 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

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**INTEVAC, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**  
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net revenues. Segment operating income excludes interest income/expense and other financial charges and income taxes according to how a particular reportable segment's management is measured. Management does not consider impairment charges and unallocated costs in measuring the performance of the reportable segments.

The Equipment segment designs, manufactures and markets manufacturing equipment and solutions to the hard disk drive industry and offers highly efficient technology solutions to the photovoltaic industry and advanced etch systems to the semiconductor industry. In 2009, the Equipment segment began offering high-efficiency, low-cost thin film solar cell manufacturing equipment to photovoltaic 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 at least the next several years will continue to be derived from the Equipment segment.

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

Information for each reportable segment for the three and nine months ended September 26, 2009 and September 27, 2008 is as follows:

**Net Revenues**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>26,</b>	<b>27,</b>	<b>26,</b>	<b>27,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>			
Equipment	\$ 12,293	\$ 22,855	\$ 24,477	\$ 75,558
Intevac Photonics	6,862	5,705	19,304	18,309
Total segment net revenues	\$ 19,155	\$ 28,560	\$ 43,781	\$ 93,867

**Operating Loss**

	<b>Three Months Ended</b>		<b>Nine Months Ended</b>	
	<b>September</b>	<b>September</b>	<b>September</b>	<b>September</b>
	<b>26,</b>	<b>27,</b>	<b>26,</b>	<b>27,</b>
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
	<b>(in thousands)</b>			
Equipment	\$ (1,836)	\$ (4,357)	\$ (14,306)	\$ (4,494)
Intevac Photonics	(628)	(1,824)	(3,248)	(3,715)
Total segment operating loss	(2,464)	(6,181)	(17,554)	(8,209)
Unallocated costs	(1,249)	(695)	(3,899)	(2,506)
Operating loss	(3,713)	(6,876)	(21,453)	(10,715)
Interest income and other, net	122	884	780	3,101
Loss before income taxes	\$ (3,591)	\$ (5,992)	\$ (20,673)	\$ (7,614)



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

Total assets for each reportable segment as of September 26, 2009 and December 31, 2008 are as follow:

**Assets**

	<b>September 26, 2009</b>	<b>December 31, 2008</b>
	<b>(in thousands)</b>	
Equipment	\$ 33,484	\$ 33,132
Intevac Photonics	25,215	23,839
Total segment assets	58,699	56,971
Cash, cash equivalents and investments	97,739	105,529
Deferred income taxes	22,236	17,969
Other current assets	4,134	3,753
Common property, plant and equipment	2,927	3,643
Other assets	955	1,304
Consolidated total assets	\$ 186,690	\$ 189,169

**13. Income Taxes**

Intevac's effective income tax rate for the three and nine months ended September 26, 2009 was 50.1% and 46.7%, respectively. Intevac's effective income tax rate for the three and nine months ended September 27, 2008 was 44.0% and 64.2%, respectively. Intevac adjusts its effective income tax rate each quarter to be consistent with the estimated annual effective income tax rate. The effective income tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits, the effect of permanent differences and the geographical composition of Intevac's worldwide earnings. Intevac's effective income tax rate is highly dependent on the availability of tax credits and the geographic composition of Intevac's worldwide earnings.

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

The fiscal 2009 income tax benefit is net of \$460,000 of unfavorable federal adjustments recorded in the third fiscal quarter related to prior year estimates for research tax credits.

Intevac is subject to income taxes in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and 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 2004. In February 2009, the state of California commenced an examination of the fiscal years ended 2005, 2006 and 2007. In September 2009, the Internal Revenue Service notified the Company that they will conduct a field review of the fiscal year 2008 tax return. Presently, there are no other active income tax examinations in the jurisdictions where Intevac operates.

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

**14. Contingencies**

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

**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 2009; 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 technology into major military programs and to develop and introduce commercial imaging products; and the timing of delivery and/or acceptance of the systems and products that comprise Intevac's backlog for revenue; legal proceedings; and internal controls. Intevac's actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under "Risk Factors" and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed in March 2009 and amended in July 2009, and our periodic Form 10-Q's and Form 8-K's.

**Overview**

Intevac provides manufacturing equipment and solutions to the hard disk drive industry and offers highly efficient technology solutions to the photovoltaic industry and advanced etch systems to the semiconductor industry. In 2009, Intevac announced a high-efficiency, low-cost thin film solar cell manufacturing system for photovoltaic applications, LEAN SOLAR™ and began offering equipment to photovoltaic cell manufacturers. Intevac also provides sensors, cameras and systems for commercial applications in the inspection, medical, scientific and security industries and for government applications such as night vision and long-range target identification. Intevac's customers and potential customers include manufacturers of hard disk drives, semiconductor chips and wafers, photovoltaic cells as well as medical, scientific and security companies, law enforcement and the U.S. government and its contractors. Intevac reports two segments: Equipment and Intevac Photonics. Effective in the second quarter of 2008, Intevac renamed the Imaging Instrumentation segment to Intevac Photonics. During the third quarter of 2008, Intevac completed the acquisition of certain assets and liabilities of the magnetic media equipment business of OC Oerlikon Balzers Ltd. (Oerlikon).

Product development and manufacturing activities occur in North America and Asia. Intevac has field offices in Asia to support its Equipment customers. Intevac's equipment and service products are highly technical and, with the exception of Japan, are sold primarily through a direct sales force. In Japan, sales are typically made by Intevac's Japanese distributor, Matsubo. During the third quarter of 2008, Intevac entered into an alliance with a Korean equipment manufacturer and distributor, TES Co., Ltd. (TES). Under the agreement TES has the rights to manufacture and sell Intevac's Lean Etch® system to the Korean and Chinese markets, and Intevac has the rights to manufacture and sell TES' chemical vapor deposition equipment to customers throughout the rest of the world. To date no sales have been made pursuant to this contract.

Intevac's results are driven primarily by worldwide demand for hard disk drives, which in turn depends on end-user demand for personal computers, enterprise data storage, personal audio and video players and video game platforms. Intevac's business is subject to cyclical industry conditions, as demand for manufacturing equipment and services can change depending on supply and demand for hard disk drives, chips, and other electronic devices, 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 nine months ended September 26, 2009 and September 27, 2008:

	Three months ended			Nine months ended		
	September 26, 2009	September 27, 2008	% Change	September 26, 2009	September 27, 2008	% Change
	(in thousands, except percentages and per share amounts)					
Net revenues	\$ 19,155	\$ 28,560	(32.9)%	\$ 43,781	\$ 93,867	(53.4)%
Gross margin	\$ 8,678	\$ 9,085	(4.5)%	\$ 17,456	\$ 37,529	(53.5)%
Gross margin percent	45.3%	31.8%	13.5%	39.9%	40.0%	(0.1)%
Net loss	\$ (1,792)	\$ (3,353)	46.6%	\$ (12,052)	\$ (2,727)	(342.0)%
Loss per diluted share	\$ (0.08)	\$ (0.15)	46.7%	\$ (0.55)	\$ (0.13)	(323.1)%

Financial results for the third quarter and first nine months of fiscal 2009 reflected a challenging environment as Intevac's Equipment customers reduced or delayed capital expenditures primarily as a result of reduced demand and overcapacity in the hard disk drive industry which occurred in the first half of 2009. Net sales decreased during the third quarter and first nine months of fiscal 2009 compared to the same periods in the prior year primarily due to lower Equipment sales to disk manufacturers partially offset by increased Intevac Photonics sales. The global economic climate caused a broad slowdown in capital equipment purchases by Intevac's hard drive customers. The net loss for the third quarter of fiscal 2009 decreased compared to the same period in the prior year due to lower operating expenses, partially offset by lower net sales, lower investment income and lower income tax benefits. The net loss for the first nine months of fiscal 2009 increased compared to the same period in the prior year due to lower net sales and lower investment income, partially offset by lower operating expenses and higher income tax benefits. The decrease in operating expenses was a result of the global cost reduction plan implemented in the fourth quarter of 2008 and continuing focus on operating efficiency. As part of the global cost reduction plan, Intevac has reduced its global workforce by 21% and reduced its global infrastructure.

For the fourth quarter of 2009, Intevac expects its Equipment revenue to increase from the third quarter of 2009 and from fourth quarter 2008 levels as a result of increased demand as customers take delivery of systems to be used in research and development including next generation patterned media production and the first new systems for manufacturing capacity increases since 2008. Intevac expects Intevac Photonics revenues in the fourth quarter of 2009 to increase from the third quarter of 2009.

For fiscal 2009, Intevac expects its Equipment revenue to decrease from 2008 levels as a result of decreased demand due to the global macroeconomic conditions as hard drive manufacturers did not add to capacity in 2009. Intevac expects Intevac Photonics revenues in fiscal 2009 to increase from fiscal 2008 levels.

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

	Three months ended			Nine months ended		
	September 26, 2009	September 27, 2008	% Change	September 26, 2009	September 27, 2008	% Change
	(in thousands, except percentages)					
Equipment	\$ 12,293	\$ 22,855	(46.2)%	\$ 24,477	\$ 75,558	(67.6)%
Intevac Photonics	6,862	5,705	20.3%	19,304	18,309	5.4%
Total net revenues	\$ 19,155	\$ 28,560	(32.9)%	\$ 43,781	\$ 93,867	(53.4)%

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

Equipment revenue for the three months ended September 26, 2009 decreased over the same period in the prior year as a result of lower sales of disk sputtering systems and spare parts, offset in part by higher sales of disk equipment technology upgrades. During the third quarter of 2009 Intevac recognized revenue on one 200 Lean system, disk equipment technology upgrades and spare parts. Equipment revenue for the nine months ended September 26, 2009 decreased over the same period in the prior year as a result of lower sales of disk sputtering systems, disk equipment technology upgrades and spare parts. Equipment revenue for the nine months ended September 26, 2009 included revenue recognition for one 200 Lean system, five AccuLuber systems, upgrades and spare parts. During the third quarter of fiscal 2008, Intevac recognized revenue on four 200 Lean systems, disk equipment technology upgrades and spare parts. Equipment revenue for the nine months ended September 27, 2008 included revenue recognition for ten 200 Lean systems, eleven disk lubrication systems, including one AccuLuber system, upgrades and spare parts. While the uncertainty of end market demand continues to dampen expectations for the hard drive market, Intevac expects that in 2009 the demand for equipment will result primarily from the need to produce patterned media development systems, incremental research and development systems, and the replacement of legacy systems with 200 Leans to support the continued growth in mobile drives.

Intevac Photonics revenue for the three and nine months ended September 26, 2009 increased over the same periods in the prior year. Intevac Photonics revenues for the three months ended September 26, 2009 consisted of \$4.5 million of research and development contract revenue and \$2.3 million of product sales as compared to \$3.3 million of research and development contract revenue and \$2.4 million of product sales for the three months ended September 27, 2008. Intevac Photonics revenues for the nine months ended September 26, 2009 consisted of \$11.5 million of research and development contract revenue and \$7.8 million of product sales as compared to \$11.5 million of research and development contract revenue and \$6.8 million of product sales for the nine months ended September 27, 2008. The increase in contract research and development revenue for the three months ended September 26, 2009 compared to the same period in the prior year was the result of a higher volume of contracts. The increase in product revenue for the nine months ended September 26, 2009 over the same period in the prior year resulted from higher sales of digital night vision camera modules, systems and commercial products. Substantial growth in future Intevac Photonics revenues is dependent on proliferation of Intevac's technology into major military programs, obtaining production subcontracts for these programs, continued defense spending, the ability to obtain export licenses for foreign customers, and development and sale of commercial products.

Intevac's backlog of orders at September 26, 2009 was \$52.2 million, as compared to \$20.2 million at December 31, 2008 and \$18.5 million at September 27, 2008. The \$52.2 million of backlog at September 26, 2009 consisted of \$38.7 million of Equipment backlog and \$13.5 million of Intevac Photonics backlog. The \$20.2 million

of backlog at December 31, 2008 consisted of \$11.4 million of Equipment backlog and \$8.8 million of Intevac Photonics backlog. Backlog at September 26, 2009 included five 200 Lean systems as compared to one at both December 31, 2008 and September 27, 2008.

International sales decreased by 59.4% to \$7.6 million for the three months ended September 26, 2009 from \$18.6 million for the three months ended September 27, 2008 and by 72.2% to \$19.4 million for the nine months

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ended September 26, 2009 from \$69.8 million for the nine months ended September 27, 2008. International sales include products shipped to overseas operations of U.S. companies. The decrease in international sales was primarily due to a decrease in net revenues from disk sputtering systems, upgrades and spare parts. Substantially all of Intevac's international sales are to customers in Asia. International sales constituted 39.6% of net revenues for the three months ended September 26, 2009 and 65.3% of net revenues for the three months ended September 27, 2008. International sales constituted 44.3% of net revenues for the nine months ended September 26, 2009 and 74.3% of net revenues for the nine months ended September 27, 2008. 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			Nine months ended		
	September 26, 2009	September 27, 2008	% Change (in thousands, except percentages)	September 26, 2009	September 27, 2008	% Change
Equipment gross profit	\$5,925	\$ 7,263	(18.4)%	\$10,132	\$ 30,869	(67.2)%
% of Equipment net revenues	48.2%	31.8%		41.4%	40.9%	
Intevac Photonics gross profit	\$2,753	\$ 1,822	51.1%	\$ 7,324	\$ 6,660	10.0%
% of Intevac Photonics net revenues	40.1%	31.9%		37.9%	36.4%	
Total gross profit	\$8,678	\$ 9,085	(4.5)%	\$17,456	\$ 37,529	(53.5)%
% of net revenues	45.3%	31.8%		39.9%	40.0%	

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. Cost of net revenues for the three and nine months ended September 26, 2009 included \$72,000 and \$283,000 of equity-based compensation expense, respectively. Cost of net revenues for the three and nine months ended September 27, 2008 included \$155,000 and \$607,000 of equity-based compensation expense, respectively.

Equipment gross margin was 48.2% in the three months ended September 26, 2009 compared to 31.8% in the three months ended September 27, 2008 and was 41.4% in the nine months ended September 26, 2009 compared to 40.9% in the nine months ended September 27, 2008. The higher gross margin for the three months ended September 26, 2009 compared to the same period in the prior year was due primarily to changes in product mix to higher-margin technology upgrades, improved factory utilization and the savings from the global cost reduction plan implemented in the fourth quarter of 2008, offset in part by lower revenues. The higher gross margin for the nine months ended September 26, 2009 compared to the same period in the prior year was due primarily to changes in product mix to higher-margin technology upgrades and the savings from the global cost reduction plan implemented in the fourth quarter of 2008, offset in part by lower revenues and costs from an acquired business. In general, 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 inventory provisions.

Intevac Photonics gross margin was 40.1% in the three months ended September 26, 2009 compared to 31.9% in the three months ended September 27, 2008 and was 37.9% in the nine months ended September 26, 2009 compared to 36.4% in the nine months ended September 27, 2008. The increase in gross margin in the three months ended September 26, 2009 compared to the same period in the prior year resulted primarily from higher-margin research and development contracts and improved factory absorption. The increase in gross margin in the nine months ended

September 26, 2009 compared to the same period in the prior year resulted primarily from changes in product mix to higher-margin product sales, offset in part by higher manufacturing costs, warranty costs and provisions for excess and obsolete inventory.

**Table of Contents***Research and Development*

	Three months ended			Nine months ended		
	September 26, 2009	September 27, 2008	% Change	September 26, 2009	September 27, 2008	% Change
	(in thousands, except percentages)					
Research and development expense	\$6,840	\$ 8,620	(20.6)%	\$22,255	\$ 26,426	(15.8)%
% of net revenues	35.7%	30.2%		50.8%	28.2%	

Research and development spending decreased in Equipment and increased in Intevac Photonics during the three and nine months ended September 26, 2009 as compared to the three and nine months ended September 27, 2008. The decrease in Equipment spending was due primarily to a reduction in spending on the Lean Etch product line (as the product design phase is substantially complete and on-going efforts are primarily related to continuous improvement) and savings from the global cost reduction plan implemented in the fourth quarter of 2008, offset by initial investment in development of photovoltaic manufacturing systems. The increase in Intevac Photonics research and development reflected increased spending for sensor yield improvements, sensor development and digital night vision system development. Research and development expense for the three and nine months ended September 26, 2009 included \$312,000 and \$1.2 million of equity-based compensation expense, respectively. Research and development expense for the three and nine months ended September 27, 2008 included \$507,000 and \$1.4 million of equity-based compensation expense, respectively. Research and development expenses do not include costs of \$2.3 million and \$6.4 million for the three and nine months ended September 26, 2009 respectively, or \$1.8 million and \$6.7 million for the three and nine months ended September 27, 2008, respectively, which are related to Intevac Photonics contract research and development and included in cost of net revenues.

*Selling, general and administrative*

	Three months ended			Nine months ended		
	September 26, 2009	September 27, 2008	% Change	September 26, 2009	September 27, 2008	% Change
	(in thousands, except percentages)					
Selling, general and administrative expense	\$5,551	\$ 7,341	(24.4)%	\$16,654	\$ 21,818	(23.7)%
% of net revenues	29.0%	25.7%		38.0%	23.2%	

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 nine months ended September 26, 2009 compared to the three and nine months ended September 27, 2008 was primarily the result of savings from the global cost reduction plan implemented in the fourth quarter of 2008. Selling, general and administrative expense for the three and nine months ended September 26, 2009 included \$615,000 and \$2.3 million of equity-based compensation expense, respectively. Selling, general and administrative expense for the three and nine months ended September 27, 2008 included \$1.1 million and \$3.0 million of equity-based compensation expense, respectively.

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

	Three months ended			Nine months ended		
	September 26, 2009	September 27, 2008	% Change	September 26, 2009	September 27, 2008	% Change
Interest income and other, net	\$ 122	\$ 884	(86.2)%	\$ 780	\$ 3,101	(74.8)%

(in thousands, except percentages)

Interest income and other, net consists primarily of interest income on investments and foreign currency gains and losses. The decrease in interest and other income in the three and nine months ended September 26, 2009 resulted from lower average invested balances, lower interest rates and fluctuations in foreign currency gains and losses.

*Income tax benefit*

	Three months ended			Nine months ended		
	September 26, 2009	September 27, 2008	% Change	September 26, 2009	September 27, 2008	% Change
Income tax benefit	\$ 1,799	\$ 2,639	(31.8)%	\$ 8,621	\$ 4,887	76.4%

(in thousands, except percentages)

Intevac's effective income tax rate for the three and nine months ended September 26, 2009 was 50.1% and 46.7%, respectively. Intevac's effective income tax rate for the three and nine months ended September 27, 2008 was 44.0% and 64.2%, respectively. Intevac adjusts its effective income tax rate each quarter to be consistent with the estimated annual effective income tax rate. The effective income tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits, the effect of permanent differences and the geographical composition of Intevac's worldwide earnings. Intevac's effective income tax rate is highly dependent on the availability of tax credits and the geographic composition of Intevac's worldwide earnings.

The fiscal 2009 income tax benefit is net of \$460,000 of unfavorable federal adjustments recorded in the third fiscal quarter related to prior year estimates for research tax credits.

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

**Liquidity and Capital Resources**

At September 26, 2009, Intevac had \$97.7 million in cash, cash equivalents, and investments compared to \$105.5 million at December 31, 2008. During the first nine months of 2009, cash and cash equivalents and investments decreased by \$7.8 million due primarily to cash used by operating activities, a scheduled payment to the owners of DeltaNu, LLC, 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.

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

	<b>September 26, 2009</b>	<b>December 31, 2008</b>
	<b>(In thousands)</b>	
Cash and cash equivalents	\$ 19,769	\$ 39,201
Short-term investments	11,997	
Long-term investments	65,973	66,328
<b>Total cash, cash equivalents and investments</b>	<b>\$ 97,739</b>	<b>\$ 105,529</b>

Operating activities used cash of \$8.5 million and \$6.0 million during the first nine months of 2009 and 2008, respectively. The increase in cash used by operating activities was due primarily to the increase in the net loss partially offset by changes in working capital during the first nine months of 2009.

Accounts receivable totaled \$12.3 million at September 26, 2009, compared to \$15.0 million at December 31, 2008. The decrease of \$2.7 million in the receivable balance was due to lower revenues and improved collection activities. Total net inventories increased to \$22.8 million at September 26, 2009, compared to \$17.7 million at December 31, 2008 primarily as a result of inventory build for planned shipments in the fourth quarter of 2009. Accounts payable increased to \$5.2 million at September 26, 2009 compared to \$4.2 million at December 31, 2008. Accrued payroll and related liabilities decreased by \$219,000 during the nine months ended September 26, 2009. Customer advances increased by \$2.9 million during the first nine months of 2009, as a result of new orders received from Intevac's customers.

Investing activities in the first nine months of 2009 used cash of \$10.0 million. Purchases of investments, net of proceeds from maturities of investments, totaled \$8.0 million. Capital expenditures for the nine months ended September 26, 2009 were \$2.0 million.

Financing activities in the first nine months of 2009 used cash of \$979,000. Intevac made a scheduled payment of \$2.0 million to the owners of DeltaNu, LLC, which Intevac acquired in the first quarter of 2007. Intevac generated \$1.0 million during the nine months ended September 26, 2009 from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

Although market conditions improved in the second half of 2009, if market conditions deteriorate, Intevac believes that its efforts to reduce costs through its global cost reduction plan and headcount restructuring activity implemented in the fourth quarter of 2008 have reduced its cash loss from operations to a level sustainable until market conditions and Intevac's business improves.

As of September 26, 2009, Intevac's available-for-sale securities represented \$70.4 million par value of auction rate securities (ARS), less a temporary valuation adjustment of \$4.4 million to reflect their current lack of liquidity. Management believes that the impairment of the ARS investments is temporary. Due to current market conditions, these investments have experienced failed auctions beginning in February 2008. These failed auctions result in a lack of liquidity in the securities, but do not affect the underlying collateral of the securities. Intevac does not anticipate that any potential lack of liquidity in these ARS will affect its ability to finance its operations and planned capital expenditures. Intevac continues to monitor efforts by the financial markets to find alternative means for restoring the liquidity of these investments. These investments are classified as non-current assets until Intevac has better visibility as to when their liquidity will be restored. The classification and valuation of these securities will continue to be reviewed quarterly. During the first nine months of 2009, \$4.0 million of ARS were redeemed at par.

As described in Note 8 of Notes to Condensed Consolidated Financial Statements, at September 26, 2009, the fair value of the ARS was estimated at \$66.0 million based on a valuation by Houlihan Smith & Company, Inc., using discounted cash flow models and applying management's internal analysis to the valuation. The estimates of future cash flows are based on certain key assumptions, such as discount rates appropriate for the type of asset and risk, which are significant unobservable inputs. As of September 26, 2009, there was insufficient observable market





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information for the ARS held by Intevac to determine the fair value. Therefore Level 3 fair values were estimated for these securities by incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions included credit quality, collateralization, final stated maturity, estimates of the probability of being called or becoming liquid prior to final maturity, redemptions of similar ARS, previous market activity for the same investment security, impact due to extended periods of maximum auction rates and valuation models.

On March 19, 2009, Intevac filed a statement of claim under the Financial Industry Regulatory Authority dispute resolution process against Citigroup Inc. and Citigroup Global Markets, Inc. (collectively, Citigroup) with respect to alleged fraud and market manipulation by Citigroup related to ARS. The statement of claim requests that Citigroup accept Intevac's tender of its ARS at par value and that Intevac receive compensatory, consequential and punitive damages and costs and expenses. Citigroup responded denying Intevac's claims. Intevac is currently in the discovery stage of this matter. An arbitration date of May 13, 2010 has been agreed upon for commencement of the arbitration of this dispute.

Intevac has entered into a line of credit with Citigroup under which approximately \$18.5 million is available. For additional information on this borrowing facility, see Note 9 of Notes to Condensed Consolidated Financial Statements.

Intevac believes that its existing cash, cash equivalents, investments and credit facility will be sufficient to meet its cash requirements for the foreseeable future. Intevac intends to undertake up to \$1.0 million in capital expenditures during the remainder of 2009 and \$4.0 to \$5.0 million in capital expenditures during fiscal 2010.

**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. 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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Management believes that the following are critical accounting policies:

***Revenue Recognition***

Intevac recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have passed to Intevac's customer or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Intevac's shipping terms are customarily FOB shipping point or equivalent terms. Intevac's revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment, Intevac recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred based on the estimated fair value, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer acceptance; and (3) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred at estimated fair value until delivery of the deferred elements. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements usually split between delivery of the parts and installation on the customer's systems. In these cases, Intevac recognizes revenue for the fair market value of the parts upon shipment and transfer of title, and recognizes revenue for the fair market value of installation services when those services are completed. Revenue related to sales of spare parts is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services.

Intevac performs research and development work under various government-sponsored research contracts. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. Intevac considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on fixed-price contracts is recognized using the percentage-of-completion method of contract accounting. Intevac determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected upon completion of the contract. When estimates of total costs to be incurred on a contract exceed total estimates of revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

***Inventories***

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

***Warranty***

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

***Income Taxes***

Intevac accounts for income taxes by recognizing deferred tax assets and liabilities using statutory tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities, net operating losses and tax credit carryforwards. Deferred tax assets are also reduced by a valuation allowance if it is more likely than not

that a portion of the deferred tax asset will not be realized. Management has determined that it is more likely than not that its future taxable income will be sufficient to realize its deferred tax assets.

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

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

***Goodwill and Purchased Intangible Assets***

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. For goodwill, Intevac performs a two-step impairment test. In the first step, Intevac compares the fair value of each reporting unit to its carrying value. Intevac's reporting units are consistent with the reportable segments identified in Note 12 of Notes to the Condensed Consolidated Financial Statements, based on the manner in which Intevac operates its business and the nature of those operations. Depending on the facts and circumstances Intevac determines the fair value of each of its reporting units based upon the most appropriate valuation technique using the income approach, the market approach or a combination thereof. The income and market approaches were selected as management believes these approaches generally provide the most reliable indications of value when the value of the operations is more dependent on the ability to generate earnings than on the value of the assets used in the production process. Under the income approach Intevac calculates the fair value of the reporting units based on the present value of estimated future cash flows. Under the market approach Intevac estimates the fair value based on market multiples of revenue or earnings for comparable companies. Each valuation technique has advantages and drawbacks, which must be considered when applying those techniques. The income approach closely correlates to management's expectations of future results but requires significant assumptions which can be highly sensitive. The market approach is relatively straightforward to measure, but it may be difficult to find directly comparable companies in the marketplace. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then Intevac would perform the second step of the impairment test in order to determine the implied fair value of the reporting unit's goodwill. If the carrying value of a reporting unit's goodwill exceeds its implied fair value, Intevac would record an impairment loss equal to the difference. In the fourth quarter of 2008, Intevac recorded an impairment charge of \$10.5 million for goodwill and purchased technology intangible assets due to a decline in market value and lower revenue expectations in light of current operating performance and future operating expectations.

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

***Equity-Based Compensation***

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

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

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

The table below presents principal amounts and related weighted-average interest rates by year of maturity for Intevac's investment portfolio at September 26, 2009.

	2009	2010	2011	Beyond	Total	Fair Value
	(in thousands, except percentages)					
Cash equivalents						
Fixed rate amounts	\$ 9,404				\$ 9,404	\$ 9,404
Weighted-average rate	0.09%					
Short-term investments						
Fixed rate amounts	\$ 11,997				\$ 11,997	\$ 11,999
Weighted-average rate	0.23%					
Long-term investments						
Fixed rate amounts				\$ 70,400	\$ 70,400	\$ 65,973
Weighted-average rate				1.40%		
Total investment portfolio	\$ 21,401			\$ 70,400	\$ 91,801	\$ 87,376

At September 26, 2009, Intevac held investments in ARS. With the liquidity issues experienced in global credit and capital markets, Intevac's ARS have experienced multiple failed auctions. Intevac continues to earn interest at the maximum contractual rate for each security. The estimated values of the ARS held by Intevac are no longer at par. As of September 26, 2009, Intevac had \$66.0 million in ARS in the condensed consolidated balance sheet, which is net of a temporary unrealized loss of \$4.4 million. Management believes that the impairment of the ARS investments is temporary, primarily due to the government guarantee of the underlying securities and Intevac's ability to hold the ARS for the foreseeable future. Management believes that it is more likely than not that it would not be required to sell these securities before the recovery of their par amounts. The unrealized loss is included in other comprehensive loss.

Intevac continues to monitor the market for ARS and consider its impact (if any) on the fair market value of its investments. If the current market conditions continue, or the anticipated recovery in market values does not occur, Intevac may be required to record additional unrealized losses or record an other-than-temporary impairment charge in 2009.

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

*Foreign exchange risk.* From time to time, Intevac enters into foreign currency forward exchange contracts to hedge certain of its anticipated foreign currency transaction, translation and re-measurement exposures. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on Intevac's operating results. At September 26, 2009, Intevac had no foreign currency forward exchange contracts.

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

Intevac maintains a set of disclosure controls and procedures that are designed to ensure that information relating to Intevac, Inc. required to be disclosed in periodic filings under the Securities Exchange Act of 1934, or Exchange Act, is recorded, processed, summarized and reported in a timely manner under the Exchange Act. In connection with the filing of this Form 10-Q for the quarter ended September 26, 2009, as required under Rule 13a-15(b) of the Exchange Act, an evaluation was carried out under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Intevac's disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, Intevac's Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 26, 2009.

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 Securities Exchange Act of 1934, as amended (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 the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

**Changes in internal controls over financial reporting**

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

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

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

On March 19, 2009, Intevac filed a statement of claim under the Financial Industry Regulatory Authority dispute resolution process against Citigroup Inc. and Citigroup Global Markets, Inc. (collectively, Citigroup) with respect to alleged fraud and market manipulation by Citigroup related to auction rate securities. The statement of claim requests that Citigroup accept Intevac's tender of its auction rate securities at par value and that Intevac receive compensatory, consequential and punitive damages and costs and expenses. Citigroup responded denying Intevac's claims. Intevac is currently in the discovery stage of this matter. An arbitration date of May 13, 2010 has been agreed upon for commencement of the arbitration of this dispute.

**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 products such as disk drives, semiconductors and photovoltaic cells. This subjects us to business cycles, the timing, length and volatility of which can be difficult to predict. When demand for commodity products exceeds production capacity, then demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of commodity products exceeds demand, then demand for new capital equipment such as ours tends to be depressed. For example, sales of systems for magnetic disk production were severely depressed from mid-1998 until mid-2003 and grew rapidly from 2004 through 2006. The number of new systems delivered in the second half of 2007 was significantly lower than the number of systems delivered in the first half of the year, and fiscal 2008 new system shipments were significantly lower than 2007. We cannot predict with any certainty when these cycles will begin or end, although we believe we entered into a downturn in the cycle in late 2007 which we expect to continue through the remainder of 2009 and potentially through 2010.

Our equipment represents only a portion of the capital expenditure that our customers incur when they upgrade or add production capacity. Accordingly, our customers generally commit to making large capital expenditures, far in excess of the cost of our systems alone, when they decide to purchase our systems. The magnitude of these capital expenditures requires our customers to have access to large amounts of capital. The magnetic disk and semiconductor manufacturing industries have made significant additions to their production capacity in the last few years. Our customers are unlikely to be willing or able to continue this level of capital investment during the recent downturn in the overall economy, or during a downturn in the hard disk drive, semiconductor, or solar 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

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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 product and installation of evaluation systems in the factories of our prospective customers. We do not enter into long-term contracts with our customers, and until an order is actually submitted by a customer there is no binding commitment to purchase our systems. Intevac Photonics' business is also subject to long sales cycles because many of its products, such as our military imaging products, often must be designed into the customers' end products, which are often complex state-of-the-art products. These development cycles are often multi-year, and our sales are contingent on our customers successfully integrating our product into their product, completing development of their product and then obtaining production orders for their product from the U.S. government or its allies.

Sales of new manufacturing systems are also dependent on obsolescence and replacement of the installed base of our customers' existing equipment with newer, more capable equipment. If upgrades are developed that extend the useful life of the installed base of legacy systems, then we tend to sell more upgrade products for the legacy systems 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 delays the replacement of such legacy 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. If alternative technologies, such as flash memory, replace hard disk drives as a primary method of digital storage, then demand for our hard disk manufacturing products would decrease.

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

Economic conditions worldwide have contributed to decreased spending by our customers and a slowdown in the hard disk drive industry. These factors have adversely impacted our operating results in prior periods, including most recently in the first three quarters of 2009, and have created significant and increasing uncertainty for the future and have caused us to be cautious about our future outlook. If adverse economic conditions persist or worsen, we could continue to experience decreased revenues from our operations. Because we have long sales cycles, even if the economic conditions improve and demand increases, there will still be a significant delay before we see an improvement in our revenues. The current recession, the continuing credit crisis that has affected worldwide financial markets, the extraordinary volatility in the stock markets, other current negative macroeconomic and global recessionary factors, and uncertainty or further weakening in key markets are expected to continue to 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, cash flow from operations and, if necessary, borrowing under our existing credit facility, we may require additional 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.



**Table of Contents*****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. In 2008, two of our customers accounted for 69% of total revenues, and four customers in aggregate accounted for 80% of total revenues. The same four customers, in aggregate, accounted for 56% of our net accounts receivable at December 31, 2008. This concentration of customers can lead to extreme variability in revenue and financial results from period to period. For example, over the last eight quarters, our revenues per quarter have fluctuated between \$12.3 million and \$33.2 million.

Industry consolidation can limit the number of potential customers for our products. For example, Seagate acquired Maxtor in 2006 and Western Digital acquired Komag in 2007. The concentration of our customer base may enable our customers to demand pricing and other terms unfavorable to Intevac, and makes us more vulnerable to changes in demand by a given customer. Orders from a relatively limited number of manufacturers have accounted for, and will likely continue to account for, a substantial portion of our revenues. The loss of one of these large customers, or delays in purchasing by them, could have a material and adverse effect on our revenues.

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

We have invested heavily, and continue to invest, in the development of new products, such as our 200 Lean Gen II system, our Lean Etch system, 200 Lean systems for photovoltaic applications and our digital night-vision products. Our success in developing and selling new products depends upon a variety of factors, including our ability to: predict future customer requirements, make technological advances, achieve a low total cost of ownership for our products, introduce new products on schedule, manufacture products cost-effectively including transitioning production to volume manufacturing; commercialize and attain customer acceptance of our products; and achieve acceptable and reliable performance of our new products in the field. Our new product decisions and development commitments must anticipate continuously evolving industry requirements significantly in advance of sales. In addition, we are attempting to expand into new or related markets, including the semiconductor market for our Lean Etch system, and the photovoltaic market. To date Intevac has not received revenue from our Lean Etch or photovoltaic manufacturing products. Failure to correctly assess the size of the markets, to successfully develop cost effective products to address the markets or to establish effective sales and support of the new products would have a material adverse effect on future revenues and profits.

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

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

Over the last eight quarters, our quarterly revenues have fluctuated between \$12.3 million and \$33.2 million and our operating loss as a percentage of revenues has fluctuated between approximately (120.2%) and (3.4%) of revenues. Over the same period, the price of our common stock has fluctuated between \$3.43 and \$18.12 per share.

We anticipate that our revenues, operating margins and common stock price will continue to fluctuate for a variety of reasons, including: (1) changes in demand due to seasonality, cyclical 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.

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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.

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

At September 26, 2009, we held auction rate securities with a par value of \$70.4 million. The market for these securities had historically been highly liquid, even though the auction rate securities that we hold have underlying maturities ranging from 23 to 39 years. The liquidity was achieved through auctions, which occurred every 7 or 28 days depending on the security, in which the interest paid on each security was reset to current market rates. We never intended to hold these securities to maturity, but rather to use the auction feature to sell the securities as needed to provide liquidity. Since February 2008, all of these auction rate securities have failed auction. The auction rate securities will continue to be illiquid until a successful auction process is reinstated, they are restructured into a more liquid security, or a buyer is found outside of the auction process. We do not know when, or if, this will occur. All of the auction rate securities held by us are student loan structured issues, originated under the U.S. Department of Education's Federal Family Education Loan Program with principal and interest 97% - 98% reinsured by the U.S. Department of Education. As of September 26, 2009, all of these securities are currently rated investment grade but there is no assurance that these ratings will continue in the future. As of September 26, 2009, securities with a par value of \$57.7 million are rated AAA/Aaa, securities with a par value of \$9.7 million are rated AAA/A3 and a security with a par value of \$3.0 million is rated AAA/Baa3. These securities are classified as long-term investments and we recorded an impairment charge of \$4.4 million. If: (1) the issuers of the auction rate securities are unable to successfully resume auctions; or (2) the issuers do not redeem the auction rate securities; or (3) a liquid market for the auction rate securities does not develop; or (4) the U.S. Department of Education fails to support its guaranty of the obligations; or (5) these or any other valuation metrics or processes change, then Intevac may be required to further adjust the carrying value of the auction rate securities and/or record an other-than-temporary impairment charge. On March 19, 2009, Intevac filed a statement of claim under the Financial Industry Regulatory Authority dispute resolution process against Citigroup Inc. and Citigroup Global Markets, Inc. (collectively, Citigroup) with respect to alleged fraud and market manipulation by Citigroup related to auction rate securities. The statement of claim requests that Citigroup accept Intevac's tender of its auction rate securities at par value and that Intevac receive compensatory, consequential and punitive damages and costs and expenses. Citigroup responded denying Intevac's claims. Intevac is currently in the discovery stage of this matter. An arbitration date of May 13, 2010 has been agreed upon for commencement of the arbitration of this dispute. We could incur significant legal costs associated with the legal action and there can be no guarantee our efforts would be successful.

In order to increase our liquidity we entered into a line of credit with Citigroup, secured by \$56.1 million in par value of our auction rate securities. At September 26, 2009, approximately \$18.5 million of credit is available pursuant to the loan facility. This loan facility may be terminated at the discretion of Citigroup and amounts outstanding are payable on demand. If we are unable to maintain this line of credit, or if the interest rate of the line of credit is prohibitive or the amount of the line of credit is insufficient, we could experience difficulties in meeting our cash requirements until the market for the auction rate securities becomes liquid again and we could have to seek additional debt funding to finance our operations, which may not be available on attractive terms, if at all.

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

As a result of our acquisitions, we have significant goodwill and intangible assets on our balance sheet. We test goodwill and intangible assets for impairment on a periodic basis as required, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The events or changes that could require us to test our goodwill and intangible assets for impairment include: a reduction in our stock price, and as a result market capitalization, changes in our estimated future cash flows, as well as changes in rates of growth in our industry or in any of our reporting units. In the fourth quarter of 2008, we recorded an impairment charge of \$10.5 million for goodwill due to a decline in our market capitalization and certain purchased technology intangible assets due to lower revenue expectations in light of current operating performance and future operating expectations. We will continue to

evaluate the carrying value of our remaining goodwill and intangible assets and if we determine in the  
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future that there is a potential further impairment in any of our reporting units, we may be required to record additional charges to earnings which could materially adversely affect our financial results and could also materially adversely affect our business.

***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 have experienced competition from Anelva Corporation, a subsidiary of Canon, which has sold substantial numbers of systems worldwide. In the market for semiconductor equipment we are attempting to enter a market dominated by competitors such as Applied Materials, LAM Research and Tokyo Electron, Ltd. In the market for photovoltaic equipment we experience competition from companies such as Veeco Instruments Inc., Centrotherm Photovoltaics AG, and cell module manufacturers that are internally developing manufacturing equipment that may be sold externally in the future. In the market for our military imaging products we experience competition from companies such as ITT Industries, Inc. and Photonis Netherlands B.V. In the markets for our commercial imaging products we compete with companies such as Andor, Dalsa, E2V, Hamamatsu, Texas Instruments and Roper Industries for sensor and camera products, and with companies such as Ahura, B&W Tek, Horiba Jobin Yvon, InPhotonics, Ocean Optics, Renishaw, and Smiths Detection for Raman spectrometer products. Our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do, especially in the semiconductor equipment market where we have not previously offered a product. We cannot ensure that our competitors will not develop enhancements to, or future generations of, competitive products that offer superior price or performance features. Likewise, we cannot ensure that new competitors will not enter our markets and develop such enhanced products. Moreover, competition for our customers is intense, and our competitors have historically offered substantial pricing concessions and incentives to attract our customers or retain their existing customers.

***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 obtain export licenses or delays in obtaining licenses, or revocation of previously issued licenses would prevent us from selling the affected products outside the United States and could negatively impact our results of operations.

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

We sell many of our imaging products and services directly to the U.S. government, as well as to prime contractors for various U.S. government programs. Our revenues from government contracts totaled \$14.8 million, \$14.1 million, and \$10.2 million in 2008, 2007, and 2006, respectively. 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



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that have resulted in losses on certain contracts, and may experience additional cost overruns in the future. We are required to recognize the total estimated impact of cost overruns in the period in which they are first identified. Such cost overruns could have a material adverse effect on our results of operations.

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

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

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

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

We booked a significant tax benefit in 2008 of which we carried back losses to years Intevac paid income taxes and which management believes we can carry-forward tax credits to future years where we would generate taxable income. Intevac will need to generate approximately \$40 million of taxable income in order to realize the Federal deferred tax assets recorded as of December 31, 2008. If our expectations of future income are incorrect, we could be required to establish a valuation allowance against some or all of the deferred tax assets.

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

In 2008, approximately 69% of our revenues came from regions outside the United States. Most of our international sales are to customers in Asia, which includes products shipped to overseas operations of U.S. companies. We currently have manufacturing facilities in California, Wyoming and Singapore and international customer support offices in Asia. 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; (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.

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

***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. Additionally, our operating results depend, in large part, upon our ability to retain and attract qualified management, engineering, marketing, manufacturing, customer support, sales and administrative personnel. Furthermore, we compete with industries, such as the hard disk drive and semiconductor industries, for skilled employees. Failure to retain 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 sub-assemblies used in our products from a single supplier or a limited group of suppliers. If any of our suppliers fail to deliver quality parts on a timely basis, we may experience delays in manufacturing, which could result in delayed product deliveries, increased costs to expedite deliveries or develop alternative suppliers, or require redesign of our products to accommodate alternative suppliers. Some of our suppliers are thinly capitalized and may be vulnerable to failure given recent economic conditions.

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

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

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

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

From time to time we may be involved in litigation of various types, including litigation alleging infringement of intellectual property rights and other claims. For example, in March 2009, Intevac filed a statement of claim under the Financial Industry Regulatory Authority dispute resolution process against Citigroup with respect to alleged fraud and market manipulation by Citigroup related to auction rate securities. The statement of claim requests that Citigroup accept Intevac's tender of its auction rate securities at par value and that Intevac receive compensatory, consequential and punitive damages and costs and expenses. Citigroup responded denying Intevac's claims. Intevac

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is currently in the discovery stage of this matter. An arbitration date of May 13, 2010 has been agreed upon for commencement of the arbitration of this dispute. 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 and in 2008 we acquired certain assets of OC Oerlikon Balzers Ltd. 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.

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

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

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

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

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, our management must perform evaluations of our internal control over financial reporting and our Form 10-K must include a report by management of their



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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, 2008, 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: (1) Intevac fails to maintain effective internal control over financial reporting; (2) our management does not timely assess the adequacy of such internal control; or (3) our independent registered public accounting firm does not deliver an unqualified opinion as to the effectiveness of our controls, then we could be subject to: (1) restatement of previously reported financial results, (2) regulatory sanctions and (3) 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. *Submission of Matters to a Vote of Security Holders***

None.

**Item 5. *Other Information***

None.

**Item 6. *Exhibits***

The following exhibits are filed herewith:

Exhibit Number	Description
23.2	Consent of Independent Valuation Firm
31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications Pursuant to U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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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: October 27, 2009

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

Date: October 27, 2009

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

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