

INTEVAC INC  
Form 10-Q  
May 03, 2016  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**Washington, DC 20549**

**FORM 10-Q**

(MARK ONE)

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

**For the quarterly period ended April 2, 2016**

**OR**

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

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

**Commission file number 0-26946**

**INTEVAC, INC.**

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

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

**94-3125814**  
**(IRS Employer**  
**Identification No.)**

**3560 Bassett Street**  
**Santa Clara, California 95054**

**(Address of principal executive office, including Zip Code)**

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

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

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

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

Large accelerated filer  Accelerated filer

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

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

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

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

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

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

See accompanying notes.

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## INTEVAC, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

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

See accompanying notes.



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## INTEVAC, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

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

See accompanying notes.



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## INTEVAC, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

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

See accompanying notes.



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**INTEVAC, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**1. Basis of Presentation**

In the opinion of management, the unaudited interim condensed consolidated financial statements of Intevac, Inc. and its subsidiaries (Intevac or the Company) included herein have been prepared on a basis consistent with the January 2, 2016 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Intevac's Annual Report on Form 10-K for the fiscal year ended January 2, 2016 ( 2015 Form 10-K ). Intevac's results of operations for the three months ended April 2, 2016 are not necessarily indicative of future operating results.

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

**2. Recent Accounting Pronouncements**

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

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

**3. Inventories**

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

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

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

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

**4. Equity-Based Compensation**

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

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

*Compensation Expense*

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

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

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

*Stock Options and ESPP*

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

term of the awards, and actual employee stock option exercise behavior.

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (Unaudited)

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

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

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

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

	Three Months Ended	
	April 2, 2016	April 4, 2015
<b>Stock Options:</b>		
Weighted-average fair value of grants per share	\$ 1.50	\$ 2.60
Expected volatility	42.96%	49.62%
Risk free interest rate	1.04%	1.00%
Expected term of options (in years)	3.96	4.00
Dividend yield	None	None
<b>Stock Purchase Rights:</b>		
Weighted-average fair value of grants per share	\$ 1.54	\$ 2.26
Expected volatility	39.33%	44.05%
Risk free interest rate	0.76%	0.39%
Expected term of purchase rights (in years)	1.93	1.22
Dividend yield	None	None

The computation of the expected volatility assumptions used in the Black-Scholes calculations for new stock option grants and ESPP purchase rights is based on the historical volatility of Intevac's stock price, measured over a period equal to the expected term of the stock option grant or purchase right. The risk-free interest rate is based on the yield available on U.S. Treasury Strips with an equivalent remaining term. The expected term of employee stock options

represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the equity-based awards and vesting schedules. The expected term of purchase rights represents the period of time remaining in the current offering period. The dividend yield assumption is based on Intevac's history of not paying dividends and the assumption of not paying dividends in the future.



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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

**RSUs**

A summary of the RSU activity is as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested RSUs at January 2, 2016	553,584	\$ 6.16
Granted	578,966	\$ 3.98
Vested	(141,839)	\$ 6.90
Cancelled and forfeited	(50,526)	\$ 4.71
Non-vested RSUs at April 2, 2016	940,185	\$ 4.78

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

Market condition-based RSUs vest upon the achievement of certain market conditions (our stock performance) during a set performance period (typically five years) subject to the grantee's continued service with Intevac through the date the applicable market condition is achieved. The fair value is based on the values calculated under the Monte Carlo simulation model on the grant date. Compensation cost is not adjusted in future periods for subsequent changes in the expected outcome of market related conditions. The compensation expense is recognized over the derived service period. We granted 125,000 of such awards to certain executive officers in the three months ended April 2, 2016. These awards have a derived service period of 2.8 years.

Intevac estimated the weighted-average fair value of market condition-based RSUs using the following weighted-average assumptions:

	Three Months Ended April 2, 2016
Weighted-average fair value of grants per share	\$ 2.46
Expected volatility	47.65%
Risk free interest rate	1.35%

Expected term (in years)	4.79
Dividend yield	None

In fiscal 2016 and fiscal 2015, the annual bonus for certain participants in the Company's annual incentive plan will be settled with RSUs with one year vesting. The Company accrued for the payment of bonuses at the expected company-wide payout percentage amount at April 2, 2016 and April 4, 2015, which amounts were less than the target bonus amounts for each participant. The bonus accrual is classified as a liability until the number of shares is determined on the date the awards are granted, at which time the Company classifies the awards into equity. In February 2016, the annual 2015 bonus for certain participants was settled with RSUs with one year vesting. 34 participants were granted stock awards to receive 266,000 shares of common stock with a weighted average grant date fair value of \$4.40 per share. In February 2015, the 2014 annual bonus for certain participants was settled with RSUs with one year vesting. 29 participants were granted stock awards to receive 133,000 shares of common stock with a weighted average grant date fair value of \$6.85 per share. The Company recorded equity-based compensation expense (credit) related to the annual incentive plans of \$115,000 and \$(51,000) for the three months ended April 2, 2016 and April 4, 2015, respectively.

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Performance-based RSUs were granted in fiscal 2013 to certain executive officers and were also subject to the achievement of specified performance goals. These performance-based RSUs became eligible to vest only if performance goals were achieved and then actually will vest only if the grantee remained employed by Intevac through each applicable vesting date. The fair value of these performance-based RSUs was estimated on the date of grant and assumed that the specified performance goals would be achieved. If the goals were achieved, these awards would vest over a specified remaining service period, provided that the grantee remained employed by Intevac through each scheduled vesting date. If the performance goals were not met, no compensation expense was recognized and any previously recognized compensation expense was reversed. The expected cost of each award was reflected over the service period and was reduced for estimated forfeitures. For performance-based awards granted during fiscal 2013, the performance goals required the achievement of targeted revenues and adjusted annual operating profit levels measured at the end of two and three-year periods. In early 2016, the Compensation Committee assessed performance against the goals following the completion of the 3-year performance period for Tranche 2 and determined that 4,920 shares of the awards had been earned and therefore were eligible for time-based vesting. In early 2015, the Compensation Committee assessed performance against the goals following the completion of the 2-year performance period for Tranche 1 and determined that 5,532 shares of the awards became earned and therefore eligible for time-based vesting.

**5. Purchased Intangible Assets**

Details of finite-lived intangible assets by segment as of April 2, 2016, are as follows.

	<b>Gross Carrying Amount</b>	<b>April 2, 2016 Accumulated Amortization (In thousands)</b>	<b>Net Carrying Amount</b>
Thin-film Equipment	\$ 7,172	\$ (4,570)	\$ 2,602
Photonics	1,215	(918)	297
	<b>\$ 8,387</b>	<b>\$ (5,488)</b>	<b>\$ 2,899</b>

Total amortization expense of finite-lived intangibles for the three months ended April 2, 2016 was \$213,000.

As of April 2, 2016, future amortization expense is expected to be as follows.

(In thousands)

2016	\$ 641
2017	754
2018	615
2019	615
2020	274
	\$ 2,899

**6. Acquisition-Related Contingent Consideration**

In connection with the acquisition of Solar Implant Technologies, Inc. ( SIT ), Intevac agreed to pay to the selling shareholders a revenue earnout in cash on Intevac s net revenue from commercial sales of certain products

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (Unaudited)

over a specified period up to an aggregate of \$9.0 million. Intevac estimated the fair value of this contingent consideration on April 2, 2016 based on probability-based forecasted revenues reflecting Intevac's own assumptions concerning future revenue from such products. As of April 2, 2016, payments made associated with the revenue earnout obligation have not been significant.

The fair value measurement of contingent consideration is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the condensed consolidated statements of operations. The following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the three-month periods ended April 2, 2016 and April 4, 2015:

	<b>Three Months Ended</b>	
	<b>April 2, 2016</b>	<b>April 4, 2015</b>
	<b>(In thousands)</b>	
Opening balance	\$ 890	\$ 1,134
Changes in fair value	16	(26)
Closing balance	\$ 906	\$ 1,108

The following table displays the balance sheet classification of the contingent consideration liability account at April 2, 2016 and at January 2, 2016:

	<b>April 2, 2016</b>	<b>January 2, 2016</b>
	<b>(In thousands)</b>	
Other accrued liabilities	\$ 182	\$ 179
Other long-term liabilities	724	711
Total acquisition-related contingent consideration	\$ 906	\$ 890

The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the contingent consideration liability as of April 2, 2016. Significant increases or decreases in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement.

**Quantitative Information about Level 3 Fair Value Measurements at April 2, 2016**

<b>Fair Value</b>	<b>Valuation Technique</b>	<b>Unobservable Input</b>	<b>Range (Weighted Average)</b>
<b>(In thousands, except for percentages)</b>			
Revenue \$ 906	Discounted cash flow	Weighted average cost of capital	15.4%
Earnout		Probability weighting of achieving	
		revenue forecasts	10.0% - 80.0% (33.5%)

**7. Warranty**

Intevac provides for the estimated cost of warranty when revenue is recognized. Intevac's warranty is per contract terms and for its disk manufacturing, PV manufacturing and display cover panel ( DCP ) manufacturing systems the warranty typically ranges between 12 and 24 months from customer acceptance. 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 Photonics products. The provision for the estimated future costs of warranty is based upon historical cost and product performance experience. Intevac exercises judgment in determining the underlying estimates.

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (Unaudited)

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

The following table displays the activity in the warranty provision account for the three-month periods ended April 2, 2016 and April 4, 2015:

	<b>Three Months Ended</b>	
	<b>April 2,</b>	<b>April 4,</b>
	<b>2016</b>	<b>2015</b>
	<b>(In thousands)</b>	
Opening balance	\$ 982	\$ 1,186
Expenditures incurred under warranties	(198)	(130)
Accruals for product warranties issued during the reporting period	114	396
Adjustments to previously existing warranty accruals	(122)	(100)
Closing balance	\$ 776	\$ 1,352

The following table displays the balance sheet classification of the warranty provision account at April 2, 2016 and at January 2, 2016:

	<b>April 2,</b>	<b>January 2,</b>
	<b>2016</b>	<b>2016</b>
	<b>(In thousands)</b>	
Other accrued liabilities	\$ 678	\$ 835
Other long-term liabilities	98	147
Total warranty provision	\$ 776	\$ 982

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

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

***Other Indemnifications***

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



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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

*Letters of Credit*

As of April 2, 2016, we had letters of credit and bank guarantees outstanding totaling \$1.8 million, including the standby letter of credit outstanding under the Santa Clara, California facility lease and a banker's guarantee which guarantees customer advances under a customer contract. These letters of credit and bank guarantees are collateralized by \$1.8 million of restricted cash.

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

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

	Amortized Cost	April 2, 2016 Unrealized Holding		Fair Value
		Gains	Losses	
	(In thousands)			
Cash and cash equivalents:				
Cash	\$ 7,414	\$	\$	\$ 7,414
Money market funds	11,787			11,787
Commercial paper	2,599			2,599
<b>Total cash and cash equivalents</b>	<b>\$ 21,800</b>	<b>\$</b>	<b>\$</b>	<b>\$ 21,800</b>
Short-term investments:				
Corporate bonds and medium-term notes	\$ 5,623	\$ 2	\$ 2	\$ 5,623
Municipal bonds	3,121	1	1	3,121
U.S. treasury and agency securities	5,996	2		5,998
<b>Total short-term investments</b>	<b>\$ 14,740</b>	<b>\$ 5</b>	<b>\$ 3</b>	<b>\$ 14,742</b>
Long-term investments:				
Corporate bonds and medium-term notes	\$ 5,451	\$ 5	\$ 2	\$ 5,454
U.S. treasury and agency securities	1,498		1	1,497
<b>Total long-term investments</b>	<b>\$ 6,949</b>	<b>\$ 5</b>	<b>\$ 3</b>	<b>\$ 6,951</b>
<b>Total cash, cash equivalents, and investments</b>	<b>\$ 43,489</b>	<b>\$ 10</b>	<b>\$ 6</b>	<b>\$ 43,493</b>



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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	Amortized Cost	January 2, 2016 Unrealized Holding Gains    Unrealized Holding Losses		Fair Value
		(In thousands)		
Cash and cash equivalents:				
Cash	\$ 6,208	\$	\$	\$ 6,208
Money market funds	7,538			7,538
Total cash and cash equivalents	\$ 13,746	\$	\$	\$ 13,746
Short-term investments:				
Corporate bonds and medium-term notes	\$ 9,978	\$	\$ 7	\$ 9,971
Municipal bonds	4,238			4,238
U.S. treasury and agency securities	8,999			8,999
Total short-term investments	\$ 23,215	\$	\$ 7	\$ 23,208
Long-term investments:				
Corporate bonds and medium-term notes	\$ 6,212	\$	\$ 23	\$ 6,189
U.S. treasury and agency securities	3,494		10	3,484
Total long-term investments	\$ 9,706	\$	\$ 33	\$ 9,673
Total cash, cash equivalents, and investments	\$ 46,667	\$	\$ 40	\$ 46,627

The following table provides the fair market value of Intevac's investments with unrealized losses that are not deemed to be other-than temporarily impaired as of April 2, 2016.

	April 2, 2016			
	In Loss Position for Less than 12 Months	Gross Unrealized Losses	In Loss Position for Greater than 12 Months	Gross Unrealized Losses
	Fair Value	Losses	Fair Value	Losses
	(in thousands)			
Corporate bonds and medium-term notes	\$ 5,167	\$ 4	\$	\$
Municipal bonds	1,446	1		
U.S. treasury and agency securities	1,497	1		

\$ 8,110      \$      6      \$              \$

The contractual maturities of available-for-sale securities at April 2, 2016 are presented in the following table.

	<b>Amortized Cost</b>	<b>Fair Value</b>
	<b>(In thousands)</b>	
Due in one year or less	\$ 29,126	\$ 29,128
Due after one through two years	6,949	6,951
	<b>\$ 36,075</b>	<b>\$ 36,079</b>

All prices for the fixed maturity securities including U.S. Treasury and agency securities, commercial paper, corporate bonds and municipal bonds are received from independent pricing services utilized by Intevac's outside investment manager. This investment manager performs a review of the pricing methodologies and inputs utilized by the independent pricing services for each asset type priced by the vendor. In addition, on at least an annual basis, the investment manager conducts due diligence visits and interviews with each pricing vendor to verify the inputs

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

utilized for each asset class. The due diligence visits include a review of the procedures performed by each vendor to ensure that pricing evaluations are representative of the price that would be received to sell a security in an orderly transaction. Any pricing where the input is based solely on a broker price is deemed to be a Level 3 price. Intevac uses the pricing data obtained from its outside investment manager as the primary input to make its assessments and determinations as to the ultimate valuation of the above-mentioned securities and has not made, during the periods presented, any material adjustments to such inputs.

The following table represents the fair value hierarchy of Intevac's available-for-sale securities measured at fair value on a recurring basis as of April 2, 2016.

	Fair Value Measurements at April 2, 2016		
	Total	Level 1	Level 2
	(In thousands)		
Recurring fair value measurements:			
Available-for-sale securities			
Money market funds	\$ 11,787	\$ 11,787	\$
U.S. treasury and agency securities	7,495	7,495	
Commercial paper	2,599		2,599
Corporate bonds and medium-term notes	11,077		11,077
Municipal bonds	3,121		3,121
Total recurring fair value measurements	\$ 36,079	\$ 19,282	\$ 16,797

**10. Derivative Instruments**

The Company uses foreign currency forward contracts to mitigate variability in gains and losses generated from the re-measurement of certain monetary assets and liabilities denominated in foreign currencies and to offset certain operational exposures from the impact of changes in foreign currency exchange rates. These derivatives are carried at fair value with changes recorded in interest income and other, net in the consolidated statements of operations. Changes in the fair value of these derivatives are largely offset by re-measurement of the underlying assets and liabilities. Cash flows from such derivatives are classified as operating activities. The derivatives have original maturities of approximately 30 days.

The following table summarizes the Company's outstanding derivative instruments on a gross basis as recorded in its condensed consolidated balance sheets as of April 2, 2016 and January 2, 2016:

Derivative Instrument	Notional Amounts		Derivative Assets		Derivative Liabilities	
	April 2, 2016	January 2, 2016	April 2, 2016	January 2, 2016	April 2, 2016	January 2, 2016
			Balance Sheet Line Value	Balance Sheet Fair Value Line Value	Balance Sheet Fair Value Line Value	Balance Sheet Fair Value Line Value
			(in thousands)			
<b>Undesignated Hedges:</b>						
Forward Foreign Currency Contracts	\$ 865	\$ 924	(a) \$	(a) \$ 1	(b) \$ 2	(b) \$ 4
<b>Total Hedges</b>	<b>\$ 865</b>	<b>\$ 924</b>	<b>\$</b>	<b>\$ 1</b>	<b>\$ 2</b>	<b>\$ 4</b>

(a) Prepaid expenses and other current assets

(b) Other accrued liabilities

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

**11. Equity*****Stock Repurchase Program***

On November 21, 2013, Intevac's Board of Directors approved a stock repurchase program authorizing up to \$30.0 million in repurchases. At April 2, 2016, \$1.5 million remains available for future stock repurchases under the repurchase program.

The following table summarizes Intevac's stock repurchases:

	<b>Three Months Ended</b>	
	<b>April 2, 2016</b>	<b>April 4, 2015</b>
	<b>(In thousands, except per share amounts)</b>	
Shares of common stock repurchased		443
Cost of stock repurchased	\$	\$ 2,987
Average price paid per share	\$	\$ 6.71

Intevac records treasury stock purchases under the cost method using the first-in, first-out (FIFO) method. Upon reissuance of treasury stock, amounts in excess of the acquisition cost are credited to additional paid-in capital. If Intevac reissues treasury stock at an amount below its acquisition cost and additional paid-in capital associated with prior treasury stock transactions is insufficient to cover the difference between the acquisition cost and the reissue price, this difference is recorded against retained earnings.

***Accumulated Other Comprehensive Income***

The changes in accumulated other comprehensive income by component for the three months ended April 2, 2016 and April 4, 2015, are as follows.

	<b>Three Months Ended</b>		<b>Three Months Ended</b>	
	<b>April 2, 2016</b>		<b>April 4, 2015</b>	
	<b>Unrealized</b>		<b>Unrealized</b>	
	<b>holding gains</b>		<b>holding gains</b>	
	<b>(losses)</b>		<b>(losses)</b>	
	<b>on</b>		<b>on</b>	
	<b>available-</b>		<b>available-</b>	
	<b>Foreign</b>	<b>for-sale</b>	<b>Foreign</b>	<b>for-sale</b>
	<b>currency</b>	<b>investments</b>	<b>currency</b>	<b>investments</b>
	<b>Total</b>		<b>Total</b>	
	<b>(In thousands)</b>			

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Beginning balance	\$ 452	\$	(40)	\$ 412	\$ 620	\$	(1)	\$ 619
Other comprehensive income before reclassification	67		44	111			29	29
Amounts reclassified from other comprehensive income								
Net current-period other comprehensive income	67		44	111			29	29
Ending balance	\$ 519	\$	4	\$ 523	\$ 620	\$	28	\$ 648



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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

**12. Net Loss Per Share**

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

	<b>Three Months Ended</b>	
	<b>April 2, 2016</b>	<b>April 4, 2015</b>
	<b>(In thousands)</b>	
Net loss	\$ (6,305)	\$ (2,893)
Weighted-average shares basic	20,551	23,229
Effect of dilutive potential common shares		
Weighted-average shares diluted	20,551	23,229
Net loss per share basic	\$ (0.31)	\$ (0.12)
Net loss per share diluted	\$ (0.31)	\$ (0.12)

As the Company is in a net loss position, all of the Company's equity instruments are considered antidilutive.

**13. Segment Reporting**

Intevac's two reportable segments are: Thin-film Equipment and Photonics. Effective in the first quarter of 2015, Intevac renamed the Equipment segment Thin-film Equipment. 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 April 2, 2016 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed.

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

Intevac derives the segment results from its internal management reporting system. The accounting policies Intevac uses to derive reportable segment results are substantially the same as those used for external reporting purposes.

Management measures the performance of each reportable segment based upon several metrics, including orders, net revenues and operating income. Management uses these results to evaluate the performance of, and to assign resources to, each of the reportable segments. Intevac manages certain operating expenses separately at the corporate level. Intevac allocates certain of these corporate expenses to the segments in an amount equal to 3% of net revenues. Segment operating income excludes interest income/expense and other financial charges and income taxes according to how a particular reportable segment's management is measured. Management does not consider impairment charges, gains and losses on divestitures and sales of intellectual property, and unallocated costs in measuring the performance of the reportable segments.

The Thin-film Equipment segment designs, develops and markets vacuum process equipment solutions for high-volume manufacturing of small substrates with precise thin-film properties, such as for the hard drive, solar cell and DCP industries, as well as other adjacent thin-film markets.

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

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

## (Unaudited)

Information for each reportable segment for the three months ended April 2, 2016 and April 4, 2015 is as follows:

*Net Revenues*

	<b>Three Months Ended</b>	
	<b>April 2, 2016</b>	<b>April 4, 2015</b>
	<b>(In thousands)</b>	
Thin-film Equipment	\$ 5,580	\$ 10,628
Photonics	8,084	9,257
<b>Total segment net revenues</b>	<b>\$ 13,664</b>	<b>\$ 19,885</b>

*Operating Loss*

	<b>Three Months Ended</b>	
	<b>April 2, 2016</b>	<b>April 4, 2015</b>
	<b>(In thousands)</b>	
Thin-film Equipment	\$ (5,445)	\$ (3,297)
Photonics	407	1,477
<b>Total segment operating profit (loss)</b>	<b>(5,038)</b>	<b>(1,820)</b>
Unallocated costs	(1,278)	(1,119)
<b>Loss from operations</b>	<b>(6,316)</b>	<b>(2,939)</b>
Interest income and other, net	37	79
<b>Loss before income taxes</b>	<b>\$ (6,279)</b>	<b>\$ (2,860)</b>

Total assets for each reportable segment as of April 2, 2016 and January 2, 2016 are as follows:

*Assets*

	<b>April 2, 2016</b>	<b>January 2, 2016</b>
	<b>(In thousands)</b>	
Thin-film Equipment	\$ 25,664	\$ 29,528
Photonics	13,549	16,029
<b>Total segment assets</b>	<b>39,213</b>	<b>45,557</b>
Cash, cash equivalents and investments	43,493	46,627
Restricted cash	1,780	1,780
Deferred income taxes	12	12
Other current assets	1,039	1,052
Common property, plant and equipment	2,049	1,218
Other assets	1,435	1,435
<b>Consolidated total assets</b>	<b>\$ 89,021</b>	<b>\$ 97,681</b>

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## INTEVAC, INC.

## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

**14. Restructuring Charges**

During the first quarter of fiscal 2015, Intevac substantially completed implementation of the 2015 cost reduction plan (the Plan), which was intended to reduce expenses and reduce its workforce by 3 percent. The cost of implementing the Plan was reported under cost of net revenues and operating expenses in the condensed consolidated statements of operations. Substantially all cash outlays in connection with the Plan occurred in the first quarter of fiscal 2015. Implementation of the Plan reduced salary, wages and other employee-related expenses by approximately \$1.4 million on an annual basis.

The changes in restructuring reserves associated with the Plan for the three months ended April 4, 2015 are as follows:

	<b>April 4, 2015 Severance and other employee- related costs (In thousands)</b>
Beginning balance	\$
Provision for restructuring reserves	148
Cash payments made	(148)
Ending balance	\$

**15. Income Taxes**

Intevac recorded income tax provisions of \$26,000 for the three months ended April 2, 2016 and of \$33,000 for the three months ended April 4, 2015. The income tax provisions for the three month periods are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates. Intevac did not recognize benefits on the U.S. net operating loss and on the Singapore net operating loss for the three month periods ended April 2, 2016 and April 4, 2015 due to having full valuation allowances on the U.S. deferred tax assets and on the Singapore deferred tax assets. Intevac's tax rate differs from the applicable statutory rates due primarily to establishment of a valuation allowance, the utilization of deferred and current credits and the effect of permanent differences and adjustments of prior permanent differences. Intevac's future effective income tax rate depends on various factors, including the level of Intevac's projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carryforwards, availability of tax credits and the effectiveness of Intevac's tax planning strategies. Management carefully monitors these factors and timely

adjusts the effective income tax rate.

The Singapore Inland Revenue Authority is currently conducting a review of the fiscal 2009 through 2012 tax returns of the Company's wholly-owned subsidiary, Intevac Asia Pte. Ltd. The Singapore Inland Revenue Authority has challenged the Company's tax position with respect to certain aspects of the Company's transfer pricing. Under Singapore tax law, the Company must pay all contested taxes and the related interest to have the right to defend its position. As a result, the Company made deposits of \$318,000 for the 2009 tax year in fiscal 2014 and \$1.1 million for the 2010 tax year in fiscal 2015, respectively. These deposits of \$1.4 million are included in other long-term assets at April 2, 2016 and January 2, 2016. The ultimate outcome of this examination is subject to uncertainty, and the Company has a liability for its uncertain tax position in Singapore as of April 2, 2016 and January 2, 2016 of \$262,000. The Company's management and its advisors continue to believe that the Company is more likely than not to successfully defend that the tax treatment was proper and in accordance with Singapore tax regulations. Based on the information currently available, the Company does not anticipate a significant increase or decrease to

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**INTEVAC, INC.**

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

**(Unaudited)**

its unrecognized tax benefits for this matter within the next twelve months. We believe that adequate amounts have been reserved for any adjustments that may ultimately result from this or other examinations. Presently, there are no other active income tax examinations in the jurisdictions where Intevac operates.

**16. Commitments and 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 2016 and beyond; projected customer requirements for Intevac's new and existing products, and when, and if, Intevac's customers will place orders for these products; Intevac's ability to proliferate its Photonics technology into major military programs and to develop and introduce commercial imaging products; the timing of delivery and/or acceptance of the systems and products that comprise Intevac's backlog for revenue and the Company's ability to achieve cost savings. Intevac's actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under Risk Factors and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed on February 17, 2016, and our periodic Form 10-Q's and Form 8-K's.

**Overview**

Intevac is a provider of vacuum deposition equipment for a wide variety of thin-film applications, and a leading provider of digital night-vision technologies and products to the defense industry. The Company leverages its core capabilities in high-volume manufacturing of small substrates to provide process manufacturing equipment solutions to the hard disk drive, solar cell and display cover panel ( DCP ) industries. Intevac also provides sensors, cameras and systems for government applications such as night vision and long-range target identification. Intevac's customers include manufacturers of hard disk media, solar cells and DCPs as well as the U.S. government and its agencies, allies and contractors. Intevac reports two segments: Thin-film Equipment and Photonics.

Product development and manufacturing activities occur in North America and Asia. Intevac has field offices in Asia to support its Thin-film Equipment customers. Intevac's products are highly technical and are sold primarily through Intevac's direct sales force. Intevac also sells its products through distributors in Japan and China.

Intevac's results are driven by a number of factors including success in its equipment growth initiatives in the DCP and solar markets and by worldwide demand for hard disk drives. Demand for hard disk drives depends on the growth in digital data creation and storage, the rate of areal density improvements, the end-user demand for PCs, enterprise data storage, nearline cloud applications, video players and video game consoles that include such drives. Intevac continues to execute its strategy of equipment diversification into new markets by introducing new products, such as for PV solar cell manufacturing and a thin-film PVD application for protective coating for DCP manufacturing. Intevac believes that expansion into these markets will result in incremental equipment revenues for Intevac and decrease Intevac's dependence on the hard disk drive industry. Intevac's equipment business is subject to cyclical industry conditions, as demand for manufacturing equipment and services can change depending on supply and demand for hard disk drives, PV cells, and cell phones as well as other factors such as global economic conditions and technological advances in fabrication processes.

The following table presents certain significant measurements for the three months ended April 2, 2016 and April 4, 2015:

	<b>Three Months Ended</b>		
	<b>April 2, 2016</b>	<b>April 4, 2015</b>	<b>Change over prior period</b>



**(In thousands, except percentages and per share**

	<b>amounts)</b>		
Net revenues	\$ 13,664	\$ 19,885	\$ (6,221)
Gross profit	\$ 3,856	\$ 6,922	\$ (3,066)
Gross margin percent	28.2%	34.8%	(6.6) points
Net loss	\$ (6,305)	\$ (2,893)	\$ (3,412)
Loss per diluted share	\$ (0.31)	\$ (0.12)	\$ (0.19)

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Net revenues decreased during the first quarter of fiscal 2016 compared to the same period in the prior year primarily due to lower Thin-film Equipment sales and lower Photonics technology development contracts. Thin-film Equipment recognized revenue on one VERTEX coating system for DCP in the first quarter of fiscal 2016 compared to one 200 Lean system and one VERTEX system in the first quarter of fiscal 2015. The net loss for the first quarter of fiscal 2016 increased compared to the same period in the prior year due to lower revenues and lower gross margins and slightly higher operating expenses as the Company made incremental investments in research and development ( R&D ).

In fiscal 2016, Intevac expects that our hard disk drive customers media production capacity will continue to exceed demand. However, the Company believes that shipments of Intevac equipment to hard disk drive manufacturers may be higher than 2015 levels as customers begin to replace older capacity tools. In 2016, Intevac expects higher sales of new thin-film equipment products as Intevac delivers the initial production shipments of our coating system for DCPs and as solar cell manufacturers begin to adopt new vacuum technologies in the manufacturing of solar cells. For fiscal 2016, Intevac expects that Photonics business levels will be about the same levels as 2015 as Photonics continues to deliver production shipments of the pilot night vision systems for the Apache helicopter and night vision camera modules for the F35 Joint Strike Fighter program.

Intevac s trademarks, include the following: 200 Lean AccuLuber , EBASNERGi , I-Port ®, INTEVAC MATRIX , MicroVista NightVista Night Port and INTEVAC VERTEX .

**Results of Operations***Net revenues*

	<b>Three Months Ended</b>		
	<b>April 2, 2016</b>	<b>April 4, 2015</b>	<b>Change over prior period</b>
	<b>(In thousands)</b>		
Thin-film Equipment	\$ 5,580	\$ 10,628	\$ (5,048)
Photonics			
Products	7,702	7,454	248
Contract R&D	382	1,803	(1,421)
	8,084	9,257	(1,173)
Total net revenues	\$ 13,664	\$ 19,885	\$ (6,221)

Thin-film Equipment revenue for the three months ended April 2, 2016 included revenue recognized for one VERTEX coating system for DCP, disk equipment technology upgrades and spare parts. Thin-film Equipment revenue for the three months ended April 4, 2015 included one 200 Lean system, one VERTEX coating system for DCP, disk equipment technology upgrades and spare parts.

Photonics revenue for the three months ended April 2, 2016 decreased over the same period in the prior year as a result of lower contract R&D work. Product sales for the three months ended April 2, 2016 were flat compared to the three months ended April 4, 2015.



**Table of Contents***Backlog*

	<b>April 2, 2016</b>	<b>January 2, 2016</b>	<b>April 4, 2015</b>
	<b>(In thousands)</b>		
Thin-film Equipment	\$ 18,347	\$ 19,337	\$ 16,156
Photonics	26,377	31,833	23,011
<b>Total backlog</b>	<b>\$ 44,724</b>	<b>\$ 51,170</b>	<b>\$ 39,167</b>

Thin-film Equipment backlog at April 2, 2016 included one PV deposition system and two PV implant systems. Thin-film Equipment backlog at January 2, 2016 includes one PV deposition system, one PVD coating system for DCPs and two PV implant systems. Thin-film Equipment backlog at April 4, 2015 included one PV deposition system and one PV implant system.

*Revenue by geographic region*

	<b>Three Months Ended</b>		
	<b>April 2, 2016</b>	<b>April 4, 2015</b>	<b>Change over prior period</b>
	<b>(In thousands)</b>		
United States	\$ 8,143	\$ 16,614	\$ (8,471)
Asia	5,295	2,388	2,907
Europe	226	883	(657)
<b>Total net revenues</b>	<b>\$ 13,664</b>	<b>\$ 19,885</b>	<b>\$ (6,221)</b>

International sales include products shipped to overseas operations of U.S. companies. The decrease in sales to the U.S. region in 2016 versus 2015 reflected lower Thin-film Equipment sales and lower contract R&D work. Sales to the U.S. region in 2015 included one 200 Lean system. The increase in sales to the Asia region in 2016 versus 2015 was primarily due to a higher ASP on the second VERTEX coating system for DCP in Thin-film Equipment. The decrease in sales to the Europe region in 2016 versus 2015 was primarily due to lower sales of Photonics digital night-vision cameras to a NATO customer.

*Gross profit*

	<b>Three Months Ended</b>		
	<b>April 2, 2016</b>	<b>April 4, 2015</b>	<b>Change over prior period</b>
	<b>(In thousands, except percentages)</b>		

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Thin-film Equipment gross profit	\$ 504	\$ 3,026	\$ (2,522)
% of Thin-film Equipment net revenues	9.0%	28.5%	
Photonics gross profit	\$ 3,352	\$ 3,896	\$ (544)
% of Photonics net revenues	41.5%	42.1%	
Total gross profit	\$ 3,856	\$ 6,922	\$ (3,066)
% of net revenues	28.2%	34.8%	

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

Thin-film Equipment gross margin was 9.0% in the three months ended April 2, 2016 and compared to 28.5% in the three months ended April 4, 2015. The decrease in margins was due to lower revenue levels, lower factory absorption, and higher provisions for excess and obsolete inventory. Gross margins in the Thin-film Equipment business will vary depending on a number of factors, including revenue levels, product mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

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Photonics gross margin was 41.5% in the three months ended April 2, 2016 compared to 42.1% in the three months ended April 4, 2015 due primarily to lower margins on contract R&D as a result of a cost overrun on a cost plus fixed fee contract that was completed in the first quarter of 2016, higher manufacturing engineering costs, offset in part by a higher mix of higher margin product sales.

*Research and development*

	<b>Three Months Ended</b>		
	<b>April 2,</b>	<b>April 4,</b>	<b>Change over</b>
	<b>2016</b>	<b>2015</b>	<b>prior</b>
			<b>period</b>
	<b>(In thousands)</b>		
Research and development expense			