INTEVAC INC
Form 10-Q
November 09, 2006

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

(Mark One)

þ **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended September 30, 2006

OR

o **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)

California	**94-3125814**
(State or other jurisdiction of incorporation or organization)	*(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 þ No o

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

Large accelerated filer o Accelerated filer þ Non-accelerated filer o

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

On November 3, 2006, 21,151,314 shares of the Registrant s Common Stock, no par value, were outstanding.

INTEVAC, INC.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

INTEVAC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	September 30, 2006	December 31, 2005
	(Unaudited) (In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 9,890	$ 15,255
Short term investments	75,967	34,476
Trade and other accounts receivable, net of allowances of $170 and $154 at September 30, 2006 and December 31, 2005	33,999	42,847
Inventories	41,372	24,837
Prepaid expenses and other current assets	2,272	1,814
Deferred tax assets	2,479	
Total current assets	165,979	119,229
Property, plant and equipment, net	11,392	7,980
Long term investments	4,000	
Investment in 601 California Avenue LLC	2,431	2,431
Other long term assets	1,770	804
Total assets	$ 185,572	$ 130,444
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 17,924	$ 7,049
Accrued payroll and related liabilities	8,026	5,509
Other accrued liabilities	6,383	6,182
Customer advances	33,849	23,136
Total current liabilities	66,182	41,876
Other long-term liabilities	955	694
Shareholders equity:		
Common stock, no par value	100,193	97,165
Additional paid in capital	2,119	
Accumulated other comprehensive income	295	238
Retained earnings (accumulated deficit)	15,828	(9,529)

Total shareholders equity	118,435	87,874
Total liabilities and shareholders equity	$ 185,572	$ 130,444

Note: Amounts as of December 31, 2005 are derived from the December 31, 2005 audited consolidated financial statements.

See accompanying notes.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
	(Unaudited) (In thousands, except per share amounts)			
Net revenues:				
Systems and components	$ 52,089	$ 41,862	$ 157,006	$ 79,001
Technology development	2,740	1,645	6,985	5,529
Total net revenues	54,829	43,507	163,991	84,530
Cost of net revenues:				
Systems and components	29,755	29,277	96,933	55,098
Technology development	1,673	1,411	4,534	4,203
Inventory provisions	121	(735)	676	19
Total cost of net revenues	31,549	29,953	102,143	59,320
Gross profit	23,280	13,554	61,848	25,210
Operating expenses:				
Research and development	8,571	3,897	20,422	10,435
Selling, general and administrative	5,565	3,746	15,683	9,678
Total operating expenses	14,136	7,643	36,105	20,113
Operating profit	9,144	5,911	25,743	5,097
Interest income and other, net	1,113	438	2,440	1,292
Income before income taxes	10,257	6,349	28,183	6,389
Provision for income taxes	1,244	158	2,826	168
Net income	$ 9,013	$ 6,191	25,357	6,221
Other comprehensive income (loss):				
Foreign currency translation adjustments	(6)	13	57	(24)
Total comprehensive income	$ 9,007	$ 6,204	$ 25,414	$ 6,197
Basic income per share:				
Net income	$ 0.43	$ 0.30	$ 1.21	$ 0.30
Shares used in per share amounts	21,082	20,567	20,967	20,400
Diluted income per share:				

Net income	$ 0.41	$ 0.29	$ 1.16	$ 0.29
Shares used in per share amounts	21,889	21,438	21,888	21,138

See accompanying notes.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005
	(Unaudited) (In thousands)	
Operating activities		
Net income	$ 25,357	$ 6,221
Adjustments to reconcile net income to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	1,881	1,537
Inventory provisions	676	19
Equity-based compensation	2,119	19
Loss on disposal of equipment	30	6
Changes in operating assets and liabilities	12,311	(12,174)
Total adjustments	17,017	(10,593)
Net cash and cash equivalents provided by (used in) operating activities	42,374	(4,372)
Investing activities		
Purchases of investments	(377,925)	(44,658)
Proceeds from maturities of investments	332,575	35,900
Purchases of leasehold improvements and equipment	(5,462)	(2,414)
Net cash and cash equivalents used in investing activities	(50,812)	(11,172)
Financing activities		
Net proceeds from issuance of common stock	3,028	2,133
Net cash and cash equivalents provided by financing activities	3,028	2,133
Effect of exchange rate changes on cash	45	(19)
Net decrease in cash and cash equivalents	(5,365)	(13,430)
Cash and cash equivalents at beginning of period	15,255	17,455
Cash and cash equivalents at end of period	$ 9,890	$ 4,025
Supplemental Schedule of Cash Flow Information		
Cash paid for:		
Income taxes	$ 4,222	$ 2

See accompanying notes.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Business Activities and Basis of Presentation

We are the world s leading supplier of sputtering equipment used to manufacture magnetic media used in hard disk drives and a developer and provider of advanced extreme low light imaging sensors, cameras and systems. We operate two businesses: Equipment and Imaging.

Our Equipment business designs, manufactures, markets and services complex capital equipment that deposits, or sputters, highly engineered thin-films onto magnetic disks used in hard disk drives. Hard disk drives are the primary storage medium for digital data and function by storing data on magnetic disks. These thin-film disks are created in a sophisticated manufacturing process involving many steps, including plating, annealing, polishing, texturing, sputtering and lubrication.

Our Imaging business develops and manufactures electro-optical sensors, cameras, and systems that permit highly sensitive detection of photons in the visible and near infrared portions of the spectrum, allowing vision in extreme low light situations. We currently develop night-vision technology and equipment for military and commercial applications.

The financial information at September 30, 2006 and for the three- and nine-month periods ended September 30, 2006 and October 1, 2005 is unaudited, but includes all adjustments (consisting only of normal recurring accruals) that we consider necessary for a fair presentation of the financial information set forth herein, in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, it does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2005.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The results for the three- and nine-month periods ended September 30, 2006 are not considered indicative of the results to be expected for any future period or for the entire year.

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2. Concentrations

Historically, a significant portion of our revenues in any particular period has been attributable to sales to a limited number of customers. Our largest customers tend to change from period to period.

We evaluate the collectibility of trade receivables on an ongoing basis and provide reserves against potential losses when appropriate.

3. New Accounting Pronouncements

In March 2004, the Emerging Issues Task Force (EITF) issued EITF No. 03-01, The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments, which provides new guidance for assessing impairment losses on debt and equity investments. The new impairment model applies to investments accounted for under the cost or equity method and investments accounted for under FAS 115, Accounting for Certain Investments in Debt and Equity Securities. EITF No. 03-01 also includes new disclosure requirements for cost method investments and for all investments that are in an unrealized loss position. In September 2004, the FASB delayed the accounting provisions of EITF No. 03-01; however, the disclosure requirements remain effective

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

and the applicable disclosures have been included in our consolidated financial statements and related notes thereto. We do not expect the adoption of this EITF to have an effect on our consolidated financial position, results of operations and cash flows.

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. This interpretation prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 will be effective beginning January 1, 2007. We are currently evaluating this interpretation to determine if it will have a material impact on our consolidated financial position, results of operations and cash flows.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. The statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within that fiscal year. We are currently evaluating the impact of adopting SFAS 157.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB 108). SAB 108 was issued in order to eliminate the diversity of practice surrounding how public companies quantify financial statement misstatements. It requires quantification of financial statement misstatements based on the effects of the misstatements on each of the company s financial statements and the related financial statement disclosures. The provisions of SAB 108 must be applied to annual financial statements no later than the first fiscal year ending after November 15, 2006. We do not expect the adoption of SAB 108 to have an effect on our consolidated financial position, results of operations and cash flows.

4. Inventories

Inventories are priced using standard costs, which approximate cost under the first-in, first-out method and are stated at the lower of cost or market. Inventories consist of the following:

	September 30, 2006	December 31, 2005
	(In thousands)	
Raw materials	$ 21,294	$ 15,070
Work-in-progress	13,249	6,303
Finished goods	6,829	3,464
	$ 41,372	$ 24,837

Finished goods inventory consists primarily of completed systems awaiting shipment to customer sites for installation and acceptance testing.

Inventory reserves included in the above numbers were $8.8 million and $11.0 million at September 30, 2006 and December 31, 2005, respectively. Each quarter, we analyze our inventory (raw materials, work-in-progress and finished goods) against the forecast demand for the next 12 months. Raw materials with no forecast requirements in that period are considered excess and inventory provisions are established to write those items down to zero net book value. Work-in-progress and finished goods inventories with no forecast requirements in that period are typically written down to the lower of cost or market. During this process, some inventory is identified as having no future use or value to us and is disposed of against the reserves.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The following table displays the activity in the inventory provision account for the nine-month periods ending September 30, 2006 and October 1, 2005:

	Nine Months Ended	
	September 30, 2006	October 1, 2005
	(In thousands)	
Beginning balance	$ 10,988	$ 9,863
New provisions in cost of sales	676	19
New provisions for refurbishment of consigned products	7	133
Disposals of inventory	(2,873)	(178)
Miscellaneous adjustments	(42)	281
Ending balance	$ 8,756	$ 10,118

5. Stock-Based Compensation

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including equity awards related to the 2004 Equity Incentive Plan (the 2004 Plan) and employee stock purchases related to the 2003 Employee Stock Purchase Plan (the ESPP) based on estimated fair values. SFAS 123(R) supersedes our previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

We adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year 2006. Our Condensed Consolidated Financial Statements as of and for the three and nine months ended September 30, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, our Condensed Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R). Stock-based compensation expense recognized under SFAS 123(R) for the three months and nine months ended September 30 was $878,000 and $2.0 million, respectively, which consisted of stock-based compensation expense related to the grant of stock options under the 2004 Plan and stock purchase rights under the ESPP. There was $19,000 of stock-based compensation expense related to the grant of stock options or stock purchase rights recognized during the three and nine months ended October 1, 2005.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The value of the portion of the award that is ultimately expected to vest is recognized as expense over the requisite service period in our Condensed Consolidated Statement of Income. Prior to the adoption of SFAS 123(R), we accounted for employee equity awards and employee stock purchases using the intrinsic value method in accordance with APB 25 as allowed under Statement of Financial Accounting Standards No. 123,

Accounting for Stock-Based Compensation (SFAS 123). Under the intrinsic value method, no stock-based compensation expense had been recognized in our Condensed Consolidated Statement of Income, because the exercise price of our stock options granted to employees and directors equaled the fair market value of the underlying stock at the date of grant.

Stock-based compensation expense recognized during the period is based on the value of the portion of share-based payment awards that is ultimately expected to vest during the period. Stock-based compensation expense recognized in our Condensed Consolidated Statement of Income for the three and nine months ended September 30, 2006 included compensation expense for share-based payment awards granted prior to, but not yet vested as of

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

December 31, 2005 based on the grant date fair value estimated in accordance with the pro forma provisions of SFAS 123 and compensation expense for the share-based payment awards granted subsequent to December 31, 2005 based on the grant date fair value estimated in accordance with the provisions of SFAS 123(R). As stock-based compensation expense recognized in the Condensed Consolidated Statement of Income for the first nine months of fiscal 2006 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. In our pro forma information required under SFAS 123 for the periods prior to fiscal 2006, the Company accounted for forfeitures as they occurred.

Descriptions of Plans

2004 Equity Incentive Plan

Our 2004 Plan is a broad-based, long-term retention program intended to attract and retain qualified management and technical employees, and align stockholder and employee interests. The 2004 Plan permits the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. Option price, vesting period, and other terms are determined by the Administrator of the 2004 Plan, but the option price shall generally not be less than 100% of the fair market value per share on the date of grant. During the nine months ended September 30, 2006, we granted 868,600 stock options with an estimated total grant-date fair value of $9.6 million. Of this amount, we estimated that the stock-based compensation for the awards not expected to vest was $3.2 million.

2003 Employee Stock Purchase Plan

Our ESPP provides that eligible employees may purchase our 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. During the three and nine months ended September 30, 2006, we granted purchase rights with an estimated total grant-date value of $1.5 million and $1.6 million, respectively.

Impact of the Adoption of SFAS 123(R)

The effect of recording stock-based compensation for the three- and nine-month periods ended July 1, 2006 was as follows:

	Three Months Ended Sept. 30, 2006	Nine Months Ended Sept. 30, 2006
	(In thousands, except per share amounts)	

Stock-based compensation by type of award:				
Stock options	$	791	$	1,687
Employee stock purchase plan		148		432
Amounts capitalized as inventory		(61)		(85)
Total stock-based compensation		878		2,034
Tax effect on stock-based compensation		(106)		(203)
Net effect on net income	$	772	$	1,831
Effect on earnings per share:				
Basic	$	0.04	$	0.09
Diluted	$	0.04	$	0.08

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Approximately $85,000 of stock-based compensation is included in inventory as of September 30, 2006. No stock-based compensation was capitalized to inventory prior to our adoption of the provisions of SFAS 123(R) in the first quarter of 2006.

Valuation Assumptions

The fair value of share-based payment awards is estimated at the grant date using the Black-Scholes Merton 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.

In connection with the adoption of SFAS 123(R), we reassessed our valuation technique and related assumptions. We estimate the fair value of stock options using a Black-Scholes Merton valuation model, consistent with the provisions of SFAS 123(R), SAB No. 107 and our prior period pro forma disclosures of net earnings, including stock-based compensation expense (determined under a fair value method as prescribed by SFAS 123). The weighted-average estimated fair value of employee stock options granted during the three and nine months ended September 30, 2006 was $9.77 per share and $11.05 per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the ESPP during the three and nine months ended September 30, 2006 was $9.94 per share and $9.68 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 Merton option valuation model with the following weighted-average assumptions:

	Three Months Ended September 30, 2006	
	Stock Options	Employee Stock Purchase Plan
Expected volatility	72.34%	59.12%
Risk free interest rate	4.54%	4.67%
Expected term of options and purchase rights (in years)	4.55	2.0
Dividend yield	None	None

	Nine Months Ended September 30, 2006	
	Stock Options	Employee Stock Purchase Plan
Expected volatility	74.82%	59.25%
Risk free interest rate	4.69%	4.67%
Expected term of options and purchase rights (in years)	4.73	1.92

Dividend yield	None	None

The computation of the expected volatility assumptions used in the Black-Scholes Merton calculations for new grants and purchase rights is based on the historical volatility of our 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 life of employee stock options represents the weighted-average period that the stock options are expected to remain outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the stock-based awards and vesting schedules. The expected life of purchase rights is the period of time remaining in the current offering period. The dividend yield assumption is based on our 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)

As the stock-based compensation expense recognized in the Condensed Consolidated Statement of Income for the first nine months of 2006 is based on awards ultimately expected to vest, such amount has been reduced for estimated forfeitures. SFAS 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on our historical experience.

Expense Information Under SFAS 123(R)

2004 Equity Incentive Plan

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

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2005	1,867,570	$ 7.19	7.55	$ 11,482,717
Options granted	868,600	$ 17.72		
Options forfeited	(48,320)	$ 9.17		
Options exercised	(295,450)	$ 7.46		
Options outstanding at September 30, 2006	2,392,400	$ 10.94	8.09	$ 15,222,090
Options exercisable at September 30, 2006	933,650	$ 7.39	6.69	$ 8,789,262

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing stock price of $16.80 as of September 29, 2006, which would have been received by the option holders had all option holders exercised their options as of that date.

The options outstanding and currently exercisable at September 30, 2006 were in the following exercise price ranges:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number of Shares Outstanding	Weighted Average Remaining Contractual Term (In Years)	Weighted Average Exercise Price	Number Vested and Exercisable	Weighted Average Exercise Price

$ 2.63 - $ 3.98	349,580	5.17	$	2.88	298,545	$	2.83
$ 3.99 - $ 6.38	267,470	7.05	$	4.56	134,680	$	4.64
$ 6.39 - $ 7.84	343,550	7.80	$	7.57	56,775	$	7.30
$ 7.85 - $10.01	313,950	8.14	$	9.03	200,400	$	9.62
$10.02 - $15.81	414,750	8.57	$	13.87	243,250	$	12.68
$15.82 - $16.13	384,100	9.92	$	16.13		$	
$16.14 - $28.55	319,000	9.59	$	20.55		$	
$ 2.63 - $28.55	2,392,400	8.09	$	10.94	933,650	$	7.39

As of September 30, 2006, the unrecorded deferred stock-based compensation balance related to stock options was $9.8 million and will be recognized over an estimated weighted average amortization period of 2.1 years. The amortization period is based on the expected term of the option, which is defined as the period from grant date to exercise date.

2003 Employee Stock Purchase Plan

During the three months ended September 30, 2006, 84,368 shares were purchased at an average per share price of $5.60. At September 30, 2006, there were 387,937 shares available to be issued under the ESPP.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Prior to the Adoption of SFAS No. 123(R)

Prior to the adoption of SFAS No. 123(R), we provided the disclosures required under SFAS No. 123, Accounting for Stock-Based Compensation, as amended by SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosures. Consistent with the disclosure provisions of SFAS 148, our net loss and basic and diluted loss per share for the three and nine months ended October 1, 2005 would have been adjusted to the pro forma amounts indicated below:

	Three Months Ended October 1, 2005	Nine Months Ended October 1, 2005
	(In thousands, except per share amounts)	
Net income, as reported	$ 6,191	$ 6,221
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(518)	(1,627)
Pro forma net income	$ 5,673	$ 4,594
Basic income per share:		
As reported	$ 0.30	$ 0.30
Pro forma	$ 0.28	$ 0.23
Diluted income per share:		
As reported	$ 0.29	$ 0.29
Pro forma	$ 0.26	$ 0.22

The weighted-average fair value of stock options granted was $8.67 and $6.79 for the three and nine months ended October 1, 2005, respectively. The weighted-average fair value of purchase rights granted was $6.00 and $5.14 for the three and for the nine months ended October 1, 2005, respectively. The fair value of each option grant and purchase right was estimated on the date of grant using the Black-Scholes Merton option valuation model with the following weighted average assumptions:

	Three Months Ended October 1, 2005		Nine Months Ended October 1, 2005	
	Employee Stock Purchase Plan	Stock Options	Employee Stock Purchase Plan	Stock Options
Expected volatility	90.20%	90.20%	91.53%	92.50%

Risk free interest rate	3.97%	4.26%	3.90%	4.32%
Expected term of options and purchase rights (in years)	1.0	5.7	1.2	6.5
Dividend yield	None	None	None	None

Prior to fiscal 2006, the expected forfeitures of employee stock options were accounted for on an as-incurred basis.

6. Warranty

We provide for the estimated cost of warranty when revenue is recognized. Our warranty is per contract terms and for our 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 life. We use estimated repair or

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

replacement costs along with our actual warranty experience to determine our warranty obligation. We exercise judgment in determining the underlying estimates.

On the condensed consolidated balance sheet, the short-term portion of the warranty is included in other accrued liabilities, while the long-term portion is included in other long-term liabilities.

The following table displays the activity in the warranty provision account for the three- and nine-month periods ending September 30, 2006 and October 1, 2005:

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
	(In thousands)			
Beginning balance	$ 4,044	$ 1,677	$ 3,399	$ 1,116
Expenditures incurred under warranties	(776)	(137)	(2,619)	(846)
Accruals for product warranties issued during the reporting period	888	1,352	2,974	2,346
Adjustments to previously existing warranty accruals	(20)	(64)	382	212
Ending balance	$ 4,136	$ 2,828	$ 4,136	$ 2,828

The following table displays the balance sheet classification of the warranty provision account at September 30, 2006 and at December 31, 2005:

	September 30, 2006	December 31, 2005
	(In thousands)	
Other accrued liabilities	$ 3,181	$ 2,705
Other long-term liabilities	955	694
Total warranty provision	$ 4,136	$ 3,399

7. Guarantees

We have entered into agreements with customers and suppliers that include limited intellectual property indemnification obligations that are customary in the industry. These obligations generally require us to compensate the other party for certain damages and costs incurred as a result of third party intellectual property claims arising from these transactions. The nature of the intellectual property indemnification obligations prevents us from making a

reasonable estimate of the maximum potential amount we could be required to pay our customers and suppliers. Historically, we have not made any significant indemnification payments under such agreements, and no amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

8. Cash, Cash Equivalents and Investments

Our investment portfolio consists of cash, cash equivalents and investments in debt securities and municipal bonds. We consider all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Investments in debt securities and municipal bonds consist principally of highly rated debt instruments with maturities generally between one and 25 months.

We account for our investments in debt securities and auction rate securities in accordance with Statement of Accounting Standards No. 115 Accounting for Certain Investments in Debt and Equity Securities, which requires certain securities to be categorized as either trading, available-for-sale or held-to-maturity. Available-for-sale securities are carried at fair value, with unrealized gains and losses recorded within other comprehensive income

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(loss) as a separate component of shareholders equity. Held-to-maturity securities are carried at amortized cost. We have no trading securities. The cost of investment securities sold is determined by the specific identification method. Interest income is recorded using an effective interest rate, with the associated premium or discount amortized to interest income. Realized gains and losses and declines in value judged to be other than temporary, if any, on available-for-sale securities are included in earnings. The table below presents the amortized principal amount, major security type and maturities for our investments in debt securities and auction rate securities.

	September 30, 2006	December 31, 2005
	(In thousands)	
Amortized Principal Amount:		
Debt securities issued by the US government and its agencies	$ 4,000	$ 10,991
Auction rate securities	70,000	15,000
Corporate debt securities	5,967	8,485
Total investments in debt securities	$ 79,967	$ 34,476
Short-term investments	$ 75,967	$ 34,476
Long-term investments	4,000	
Total investments	$ 79,967	$ 34,476
Approximate fair value of investments in debt securities	$ 79,964	$ 34,408

The decline in the fair value of our investments from the principal amount is attributable to changes in interest rates and not credit quality. In accordance with EITF 03-01, we have the ability and intent to hold these investments until fair value recovers, which may be maturity, and we do not consider these investments to be other-than-temporarily impaired at September 30, 2006.

Cash and cash equivalents represent cash accounts and money market funds. Included in accounts payable are $5.6 million and $988,000 of book overdraft at September 30, 2006 and December 31, 2005, respectively.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Net Income Per Share

The following table sets forth the data used in the computations of basic and diluted earnings per share:

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
	(In thousands)			
Numerator:				
Numerator for diluted earnings per share income available to common stockholders	$ 9,013	$ 6,191	$ 25,357	$ 6,221
Denominator:				
Denominator for basic earnings per share weighted-average shares	21,082	20,567	20,967	20,400
Effect of dilutive securities:				
Employee stock options(1)	817	871	921	738
Dilutive potential common shares	817	871	921	738
Denominator for diluted earnings per share adjusted weighted-average shares and assumed conversions	21,899	21,438	21,888	21,138

(1) Potentially dilutive securities, consisting of shares issuable upon exercise of employee stock options and weighted-average unamortized compensation expense, are excluded from the calculation of diluted EPS when their effect is anti-dilutive. The weighted average number of employee stock options excluded for the three-month periods ended September 30, 2006 and October 1, 2005 was 566,079 and 137,198, respectively, and the number of employee stock options excluded for the nine-month periods ended September 30, 2006 and October 1, 2005 was 319,786 and 233,414, respectively.

10. Segment Reporting

Segment Description

We have two reportable operating segments: Equipment and Imaging. Our reportable segments are business units that offer different products and are each managed separately, under the direction of our Chief Executive Officer. Our Equipment business designs, manufactures, markets and services complex capital equipment that deposits, or sputters, highly engineered thin-films onto magnetic disks used in hard disk drives. Our Imaging business develops and manufactures electro-optical sensors, cameras and systems that permit highly sensitive detection of photons in the visible and near infrared portions of the spectrum, allowing vision in extreme low light situations.

Included in corporate activities are general corporate expenses, less an allocation of corporate expenses to operating units equal to 3% of net revenues. Assets of corporate activities include unallocated cash and investments, deferred income tax assets and other assets.

Segment Profit or Loss and Segment Assets

We evaluate performance and allocate resources based on a number of factors including, profit or loss from operations and future revenue potential. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Business Segment Net Revenues

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
	(In thousands)			
Equipment	$ 51,625	$ 41,519	$ 155,663	$ 78,392
Imaging	3,204	1,988	8,328	6,138
Total	$ 54,829	$ 43,507	$ 163,991	$ 84,530

Business Segment Profit & Loss

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
	(In thousands)			
Equipment	$ 9,833	$ 7,177	$ 29,287	$ 9,178
Imaging	(673)	(1,415)	(3,701)	(3,874)
Corporate activities	(16)	149	157	(207)
Operating income	9,144	5,911	25,743	5,097
Interest income and other, net	1,113	438	2,440	1,292
Income before income taxes	$ 10,257	$ 6,349	$ 28,183	$ 6,389

Business Segment Assets

	September 30, 2006	December 31, 2005
	(In thousands)	
Equipment	$ 78,246	$ 68,672
Imaging	8,739	7,665
Corporate activities	98,587	54,107
Total	$ 185,572	$ 130,444

Geographic Area Net Trade Revenues

	Three Months Ended		Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
	(In thousands)			
United States	$ 5,665	$ 6,315	$ 22,294	$ 15,898
Asia	48,937	36,971	141,453	67,938
Europe	227	221	244	694
Total	$ 54,829	$ 43,507	$ 163,991	$ 84,530

11. Income Taxes

For the nine- month period ended September 30, 2006, we accrued income tax using an effective tax rate of 10.0% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes . We have substantial net

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

operating loss carry-forwards and deferred credits, which are being used to limit the taxes paid this year and to reduce our effective tax rate to less than the statutory income tax rates in effect. We expect our effective tax rate to significantly increase after our net operating losses and deferred credits have been fully utilized. Our deferred tax asset is mostly offset by a valuation allowance, resulting in a net deferred tax asset of $2.5 million at September 30, 2006.

For the three-and nine-month periods ended October 1, 2005, we accrued income tax using an effective tax rate of 2.5% of pretax income. Our tax rate differs from the applicable statutory rates due to the utilization of net operating loss carry-forwards and deferred credits.

12. Capital Transactions

During the nine-month period ending September 30, 2006, we sold stock to our employees under Intevac s Stock Option and Employee Stock Purchase Plans. A total of 454,309 shares were issued under these plans, for which Intevac received $3.0 million.

13. Financial Presentation

Certain prior year amounts in the Condensed Consolidated Financial Statements have been reclassified to conform to 2006 presentation. The reclassification involved combining interest expense, interest income and other income, net, into a single line on the Condensed Consolidated Statements of Income and Comprehensive Income. The reclassifications had no material effect on total assets, liabilities, equity, revenue, net income or comprehensive income as previously reported.

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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 our shipments, projected revenue recognition, product costs, gross margin, operating expenses, interest income, cash balances and financial results in 2006; our projected customer requirements for new capacity and for technology upgrades for their installed base of our thin-film disk sputtering equipment, and when, and if, our customers will place orders for these products; Imaging s ability to proliferate its technology into major military weapons programs and to develop and introduce commercial imaging products; and the timing of delivery and/or acceptance of the systems and products that comprise our backlog for revenue. Our 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 Intevac s Annual Report on Form 10-K filed in March 2006, Form 10-Q s and Form 8-K s.

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. Our significant accounting policies are described in Note 2 to the consolidated financial statements included in Item 8 of our 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 our financial statements and requires management to make difficult, subjective or complex judgments that could have a material effect on our financial conditions and results of operations. Specifically, critical accounting estimates have the following attributes: 1) We are required to make assumptions about matters that are highly uncertain at the time of the estimate; and 2) different estimates we could reasonably have used, or changes in the estimate that are reasonably likely to occur, would have a material effect on our financial condition or results of operations.

Estimates and assumptions about future events and their effects cannot be determined with certainty. We base our 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 our 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 our accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that our consolidated financial statements are fairly stated in accordance with US GAAP, and provide a meaningful presentation of our financial condition and results of operation.

We believe the following critical accounting policies affect the more significant judgments and estimates we make in preparing our consolidated financial statements. We also have other key accounting policies and accounting estimates related to the collectibility of trade receivables and prototype product costs. We believe that these other accounting policies and other accounting estimates either do not generally require us to make estimates and judgments that are as difficult or subjective, or are less likely to have a material impact on our reported results of operation for a given period.

Revenue Recognition

Certain of our system sales with customer acceptance provisions are accounted for as multiple-element arrangements. If we have previously met defined customer acceptance levels with the specific type of system, then we recognize revenue for the fair market value of the system upon shipment and transfer of title, and recognize revenue for the fair market value of installation and acceptance services when those services are completed. We estimate the fair market value of the installation and acceptance services based on our actual historical experience. For systems that have generally not been demonstrated to meet a particular customer s product specifications prior

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to shipment, revenue recognition is typically deferred until customer acceptance. For example, while initial shipments of our 200 Lean®system were recognized for revenue upon customer acceptance during 2004, revenue was recognized upon shipment for the majority of 200 Leans shipped in 2005 and 2006. Most of the systems in backlog at September 30, 2006 are for customers where we have met defined customer acceptance levels and we expect to recognize revenue upon shipment for those systems.

In some instances, hardware that is not essential to the functioning of the system may be delivered after acceptance of the system. In these cases, we estimate the fair market value of the non-essential hardware as if it had been sold on a stand-alone basis, and defer recognizing revenue on that value until the hardware is delivered.

In certain cases, we sell limited rights to our intellectual property. Revenue from the sale of any intellectual property license will generally be recognized at the inception of the license term.

We perform best efforts research and development work under various government-sponsored research contracts. These contracts are a mixture of cost-plus-fixed-fee (CPFF) and firm fixed-price (FFP). Revenue on CPFF contracts is recognized in accordance with contract terms, typically as costs are incurred. Revenue on FFP contracts is generally recognized on the percentage-of-completion method based on costs incurred in relation to total estimated costs. Provisions for estimated losses on government-sponsored research contracts are recorded in the period in which such losses are determined.

Inventories

Inventories are priced using standard costs, which approximate cost under the first-in, first-out method, and are stated at the lower of cost or market. The carrying value of inventory is reduced for estimated excess and obsolescence by the difference between its cost and the estimated market value based on assumptions about future demand. We evaluate 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 would be required, which could have a material adverse effect on our business, financial condition and results of operation. A cost-to-market reserve is established for work-in-progress and finished goods inventories when the value of the inventory plus the estimated cost to complete exceeds the net realizable value of the inventory.

Warranty

We provide for the estimated cost of warranty when revenue is recognized. Our warranty is per contract terms and for our systems the warranty typically ranges between 12 and 24 months from customer acceptance. We use estimated repair or replacement costs along with our actual warranty experience to determine our warranty obligation. We exercise judgment in determining the underlying estimates. Should actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required, which could have a material adverse effect on our business, financial condition and results of operations.

Income Taxes

We account for income taxes in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes, (SFAS 109) which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. Based on our history of losses through 2004, our deferred tax asset was

fully offset by a valuation allowance as of December 31, 2005.

On a quarterly basis, we provide for income taxes based upon an annual effective income tax rate. The effective tax rate is highly dependent upon the level of our projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carry-forwards, availability of tax credits and the effectiveness of our tax planning strategies. We carefully monitor the changes in many factors and adjust our effective income tax rate on a timely basis. If actual results differ from the estimates, this could have a material

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effect on our business, financial condition and results of operations. For example, as our projected level of earnings increased throughout 2006, we increased the annual effective tax rate from 3.0% at the end of the first quarter, to 8.8% at the end of the second quarter and to 10.0% at the end of the third quarter.

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 our expectations could have a material effect on our business, financial condition and results of operations.

Results of Operations

Three Months Ended September 30, 2006 and October 1, 2005.

Net revenues

	Three months ended		Change over prior period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Equipment net revenues	$ 51,625	$ 41,519	$ 10,106	24%
Imaging net revenues	3,204	1,988	1,216	61%
Total net revenues	$ 54,829	$ 43,507	$ 11,322	26%

Net revenues consist primarily of sales of equipment used to manufacture thin-film disks, related equipment and system components, flat panel equipment technology license fees, contract research and development related to the development of electro-optical sensors, cameras and systems and low light imaging products.

Equipment revenue for the three months ending September 30, 2006 included revenue recognition for nine 200 Lean systems and three disk lubrication systems, and a significant quarter over quarter increase in revenue from disk equipment technology upgrades and spare parts. Revenue for the three months ended October 1, 2005 included seven 200 Lean systems, two MDP-250B systems, nine disk lubrication systems and one flat panel manufacturing system. Our outlook for the Equipment business continues to be positive and we expect our revenues will increase significantly in the fourth quarter of 2006.

Imaging revenue for the three months ending September 30, 2006 consisted of $2.7 million of contract research and development and $465,000 of product sales. Revenue for the three months ended October 1, 2005 consisted of $1.7 million of contract research and development and $343,000 of product sales. The increase in contract research and development revenue was the result of a better mix of fully funded vs. partially funded programs. Substantial growth in future Imaging revenues is dependent on proliferation of our technology into major military weapons programs, the ability to obtain export licenses for foreign customers, obtaining production subcontracts for these programs, and development and sale of commercial products.

Our backlog of orders at September 30, 2006 was $129.7 million, as compared to $84.5 million at December 31, 2005 and $65.4 million at October 1, 2005. The increase in backlog was primarily the result of orders for disk sputtering systems. We include in backlog the value of purchase orders for our products that have scheduled delivery dates. We do not recognize revenue on this backlog until we have met the criteria contained in our revenue recognition policy,

including customer acceptance of newly developed systems.

International sales increased by 32% to $49.2 million for the three months ended September 30, 2006 from $37.2 million for the three months ended October 1, 2005. International revenues include products shipped to overseas operations of U.S. companies. The increase in international sales was primarily due to an increase in net revenues from disk equipment technology upgrades and spare parts. Substantially all of our international sales are to customers in Asia. International sales constituted 90% of net revenues for the three months ended September 30, 2006 and 86% of net revenues for the three months ended October 1, 2005.

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Gross margin

	Three months ended		Change over prior period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Equipment gross margin	42.5%	32.0%	10.5 pts	33%
Imaging gross margin	41.1%	13.8%	27.3 pts	198%
Total gross margin	42.5%	31.2%	11.3 pts	36%

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 months ended September 30, 2006 included $70,000 of equity-based compensation expense.

Equipment gross margin improved during the three months ended September 30, 2006 as compared to the three months ended October 1, 2005. Our product mix, cost reduction programs and increased volume all contributed to the higher gross margin for the quarter. We expect the gross margin for the Equipment business in the fourth quarter of 2006 to be better than the fourth quarter of 2005, but lower than the margin achieved in the third quarter of 2006. 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.

The increase in Imaging gross margin resulted from a higher percentage of contract research and development revenue being derived from fully funded contracts, favorable adjustments related to closing our prior year government rate audits and increased product shipments. We expect Imaging gross margin in the fourth quarter of 2006 to be lower than the third quarter of 2006, due primarily to the elimination of the one-time favorable adjustments recognized in the three months ended September 30, 2006.

Research and development

	Three months ended		Change over prior period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Research and development expense	$ 8,571	$ 3,897	$ 4,674	120%
% of net revenues	15.6%	9.0%		

Research and development expense consists primarily of prototype materials, salaries and related costs of employees engaged in ongoing research, design and development activities for disk sputtering equipment and Imaging products.

Research and development spending increased in both Equipment and in Imaging during the three months ended September 30, 2006 as compared to the three months ended October 1, 2005. The increase in Equipment was due to

spending on the development of a new product line and spending for continuing development of our disk sputtering products. The increase in Imaging was due primarily to increased spending on the development of our commercial Imaging products. Engineering headcount increased from 86 at October 1, 2005 to 115 at September 30, 2006. Included in research and development spending for the three months ended September 30, 2006 was $376,000 of equity-based compensation expense. We expect that research and development spending will increase in the fourth quarter of 2006 due primarily to expenditures related to our new Equipment product line, provisions for employee profit-sharing and bonus plans, and equity-based compensation expense.

Research and development expenses do not include costs of $1.7 million and $1.4 million for the three-month periods ended September 30, 2006 and October 1, 2005, respectively, which are related to contract research and development and included in cost of net revenues.

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Selling, general and administrative

	Three Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Selling, general and administrative expense	$ 5,565	$ 3,746	$ 1,819	49%
% of net revenues	10.1%	8.6%		

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs and also includes production of customer samples, travel, liability insurance, legal and professional services and bad debt expense. All domestic sales and international sales of disk sputtering products in Asia, with the exception of Japan, are typically made by Intevac s direct sales force, whereas sales in Japan of disk sputtering products and other products are typically made by our Japanese distributor, Matsubo, who provides services such as sales, installation, warranty and customer support. We also have subsidiaries in Singapore and in Hong Kong, along with field offices in Japan, Malaysia, Korea and Shenzhen, China to support our equipment customers in Asia.

The increase in selling, general and administrative spending in the three months ended September 30, 2006 as compared to the three months ended October 1, 2005 was primarily the result of increases in costs related to business development, customer service and support in the Equipment business and provisions for employee profit sharing and bonus plans. Included in selling, general and administrative spending for the three months ended July 1, 2006 was $432,000 of equity-based compensation expense. Our selling, general and administrative headcount increased from 59 at October 1, 2005 to 71 at September 30, 2006. We expect that selling, general and administrative expenses will increase in the fourth quarter of 2006 due primarily to a projected increase in costs related to business development, customer service and support for the Equipment business, provisions for employee profit-sharing and bonus plans, and stock-based compensation expense.

Interest income and other, net

	Three Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Interest income and other, net	$ 1,113	$ 438	$ 675	154%

Interest income and other, net consists primarily of interest and dividend income on investments and foreign currency transaction gains and losses. The increase in the three months ended September 30, 2006 was driven by higher interest rates on our investments and a higher average invested balance.

Provision for income taxes

	Three Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%

	(In thousands, except percentages)			
Provision for income taxes	$ 1,244	$ 158	$ 1,086	687%

For the three months ended September 30, 2006, we accrued income tax using an effective tax rate of 12.1% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes . We have substantial net operating loss carry-forwards and deferred credits, which are being used to limit the taxes paid this year and to reduce our effective tax rate to less than the statutory income tax rates in effect. We expect our effective tax rate to significantly increase after our net operating losses and deferred credits have been fully utilized. Our deferred tax asset is mostly offset by a valuation allowance, resulting in a net deferred tax asset of $2.5 million at September 30, 2006.

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For the three months ended October 1, 2005, we accrued income tax using an effective tax rate of 2.5% of pretax income. Our tax rate differs from the applicable statutory rates due to the utilization of net operating loss carry-forwards and deferred credits.

Nine Months Ended September 30, 2006 and October 1, 2005

Net revenues

	Nine Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Equipment net revenues	$ 155,663	$ 78,392	$ 77,271	99%
Imaging net revenues	8,328	6,138	2,190	36%
Total net revenues	$ 163,991	$ 84,530	$ 79,461	94%

The increase in Equipment revenue was the result of higher sales of disk sputtering systems, disk equipment technology upgrades and spare parts. The increase in Imaging revenues was the result of both higher product sales and higher contract research and development revenues.

International sales increased by 106% to $141.7 million for the nine months ended September 30, 2006 from $68.6 million for the nine months ended October 1, 2005. The increase in international sales was due to higher shipments of disk sputtering systems to customers in Asia. International sales constituted 86% of net revenues for the nine months ended September 30, 2006 and 81% of net revenues for the nine months ended October 1, 2005. International revenues include products shipped to overseas operations of US companies.

Gross margin

	Nine Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
Equipment gross margin	38.0%	31.2%	6.8 pts	22%
Imaging gross margin	31.6%	12.7%	18.9 pts	149%
Total gross margin	37.7%	29.8%	7.9 pts	27%

Gross margin for the nine months ended September 30, 2006 increased relative to the comparable 2005 period primarily due to lower manufacturing costs and higher average selling prices for the 200 Lean systems recognized for revenue and increased sales of disk equipment technology upgrades and spare parts in the period relative to the nine months ended October 1, 2005. The increase in Imaging gross margin was primarily a result of favorable adjustments related to closing our prior year rate audits and a higher percentage of revenue being derived from fully funded development contracts and product sales. Cost of net revenues for the nine months ended September 30, 2006

included $242,000 of equity-based compensation expense.

Gross margin for the nine months ended October 1, 2005 was favorably impacted by $908,000 of flat panel equipment related activities. The $908,000 included $1.5 million of gross profit from the technology license sale less $592,000 for costs related to obtaining final customer acceptance of a flat panel manufacturing system shipped in 2003. Gross margin for the nine months ended October 1, 2005 was adversely impacted by the recognition of revenue on a 200 Lean system that was built early in 2004, prior to the completion of a number of cost reduction activities.

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Research and development

	Nine Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Research and development expense	$ 20,422	$ 10,435	$ 9,987	96%
% of net revenues	12.5%	12.3%		

Research and development spending increased in both Equipment and in Imaging during the nine months ended September 30, 2006 as compared to the nine months ended October 1, 2005. The increase in Equipment was due to spending on the development of a new product line and spending for continuing development of our disk sputtering products. The increase in Imaging was due primarily to spending on the development of our commercial Imaging products. Included in research and development spending for the nine months ended September 30, 2006 was $908,000 of equity-based compensation expense.

Research and development expenses do not include costs of $4.5 million and $4.2 million, respectively, for the nine-month periods ended September 30, 2006 and October 1, 2005 related to Imaging contract research and development. These expenses are included in cost of net revenues.

Selling, general and administrative

	Nine Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Selling, general and administrative expense	$ 15,683	$ 9,678	$ 6,005	62%
% of net revenues	9.6%	11.4%		

The increase in selling, general and administrative expense for the nine months ending September 30, 2006 was primarily the result of increases in costs related to business development, customer service and support in the Equipment business and provisions for employee profit sharing and bonus plans. Included in selling, general and administrative spending for the nine months ended September 30, 2006 was $883,000 of equity-based compensation expense.

Interest income and other, net

	Nine Months Ended		Change Over Prior Period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Interest income and other, net	$ 2,440	$ 1,292	$ 1,148	89%

Interest income and other, net in both 2006 and 2005 consisted primarily of interest and dividend income on investments. The increase in the nine months ended September 30, 2006 was the driven by higher interest rates on our investments and a higher average invested balance.

Provision for income taxes

	Nine months ended		Change over prior period	
	Sept. 30, 2006	Oct. 1, 2005	Amount	%
	(In thousands, except percentages)			
Provision for income taxes	$ 2,826	$ 168	$ 2,658	1,582%

For the nine months ended September 30, 2006, we accrued income tax using an effective tax rate of 10.0% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes .

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Income tax expense for the nine months ending October 1, 2005 consists of a 2.5% provision on net pretax income, minimum Franchise Tax payment of $2,400 to the State of California and a $7,000 accrual related to a claim we received from the California Franchise Tax Board.

Stock-Based Compensation

On January 1, 2006, we adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors including equity awards related to the 2004 Equity Incentive Plan (employee equity awards) and employee stock purchases related to the 2003 Employee Stock Purchase Plan (employee stock purchases) based on estimated fair values. SFAS 123(R) supersedes our previous accounting under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) for periods beginning in fiscal 2006. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 107 (SAB 107) relating to SFAS 123(R). We have applied the provisions of SAB 107 in our adoption of SFAS 123(R).

We adopted SFAS 123(R) using the modified prospective transition method, which requires the application of the accounting standard as of January 1, 2006, the first day of our fiscal year 2006. Our Condensed Consolidated Financial Statements as of and for the three and nine months ended September 30, 2006 reflect the impact of SFAS 123(R). In accordance with the modified prospective transition method, our Condensed Consolidated Financial Statements for prior periods have not been restated to reflect, and do not include, the impact of SFAS 123(R).

During the three and nine months ended September 30, 2006, we recorded stock-based compensation expense related to stock options of $791,000 and $1,687,000 respectively. As of September 30, 2006, the unrecorded deferred stock-based compensation balance related to stock options was $9.8 million and will be recognized over an estimated weighted average amortization period of 2.1 years.

The compensation cost associated with the employee stock purchase plan for the three and nine months ended September 30, 2006 was $148,000 and $432,000 respectively. There were 158,859 shares purchased under the employee stock purchase plan during the nine months ended September 30, 2006.

Approximately $61,000 and $85,000 of stock-based compensation was capitalized as inventory at the three- and nine-month periods ended September 30, 2006. No stock-based compensation was capitalized to inventory prior to our adoption of the provisions of SFAS 123(R) in the first quarter of 2006.

Liquidity and Capital Resources

During the first nine months of 2006, cash, cash equivalents, and investments increased by $40.2 million, from $49.7 million at December 31, 2005 to $89.9 million as of September 30, 2006.

Operating activities provided cash of $42.4 million during the nine months ended September 30, 2006. The cash provided was due primarily to net income, adjusted to exclude the effect of non-cash charges including depreciation and equity-based compensation, and to an increase in accounts payable. This was partially offset by increases in inventory and other prepaid expenses. Accounts receivable totaled $34.0 million at September 30, 2006 compared to $42.8 million at December 31, 2005. Net inventories increased by $16.6 million during the nine months ended September 30, 2006 due to increases in raw materials, work-in-progress and finished goods, which will be used to support the September 30, 2006 backlog. Accounts payable totaled $17.9 million at September 30, 2006 compared to $7.0 million at December 31, 2005. The increase of $10.9 million relates to the increase in inventory purchases and the general growth of our business. Accrued payroll and related liabilities increased by $2.5 million during the nine

months ended September 30, 2006 due primarily to increases in headcount and accruals for bonuses and employee profit sharing. Other accrued liabilities totaled $7.3 million at September 30, 2006 compared to $6.9 million at December 31, 2005. The minimal net increase relates to an increase in accruals for warranty obligations, partially offset by decreases in accruals for taxes and deferred income. Customer advances increased by $10.7 million during the nine months ended September 30, 2006. The increase was due to advances billed or received for orders that will be shipped during the balance of 2006 and in 2007.

Investing activities in the first nine months of 2006 used cash of $50.8 million. Purchases of investments, net of proceeds from sales and maturities, totaled $45.3 million. Capital expenditures for the nine months ended September 30, 2006 were $5.5 million.

Financing activities provided cash of $3.0 million during the nine months ended September 30, 2006 due to the sale of Intevac common stock to our employees through our employee benefit plans.

We have generated operating income each of the last six quarters, after incurring annual operating losses from 1997 through 2004. We believe the upturn in demand for the type of disk manufacturing equipment we produce is continuing, and we expect our Equipment business to be profitable for the balance of 2006 and into 2007.

We believe that our existing cash, cash equivalents and short-term investments, combined with the cash we anticipate generating from operating activities will be sufficient to meet our cash requirements for the foreseeable future. We intend to undertake approximately $5 to $6 million in capital expenditures during the reminder of 2006.

Contractual Obligations

In the normal course of business, we enter into various contractual obligations that will be settled in cash. These obligations consist primarily of operating lease and purchase obligations. The expected future cash flows required to meet these obligations as of September 30, 2006 are shown in the table below.

			Payments due by Period		
	Total	**< 1 Year**	**1-3 Years**	**3-5 Years**	**> 5 Years**
			(In thousands)		
Operating lease obligations	$ 11,257	$ 2,792	$ 3,638	$ 3,703	$ 1,124
Purchase obligations	37,588	37,588			
Total	$ 48,845	$ 40,380	$ 3,638	$ 3,703	$ 1,124

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

Interest rate risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We place our investments with high quality credit issuers and, by policy, limit the amount of credit exposure to any one issuer. Short-term investments typically consist of investments in commercial paper, auction rate securities and debt instruments issued by the US government and its agencies.

The table below presents principal amounts and related weighted-average interest rates by year of maturity for our investment portfolio at September 30, 2006.

	2006	**2007**	**2008**	**Beyond**	**Total**	**Fair Value**
Cash equivalents						
Fixed rate amounts	$ 1,999				$ 1,999	$ 1,997

Weighted-average rate	5.30%					
Variable rate amounts	$ 3,471				$ 3,471	$ 3,471
Weighted-average rate	5.24%					
Short-term investments						
Fixed rate amounts	$ 73,963	$ 2,005			$ 75,968	$ 75,963
Weighted-average rate	5.24%	4.80%				
Long-term investments						
Fixed rate amounts			$ 4,000		$ 4,000	$ 4,001
Weighted-average rate	5.44%					
Total investment portfolio	$ 79,433	$ 2,005	$ 4,000		$ 85,438	$ 85,432

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Due to the short-term nature of the substantial portion of our investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates.

Foreign exchange risk. From time to time, we enter into foreign currency forward exchange contracts to economically hedge certain of our 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 our operating results. At September 30, 2006, we had no foreign currency forward exchange contracts.

Item 4. ***Controls and Procedures***

Evaluation of disclosure controls and procedures

We maintain 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 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 30, 2006, 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 our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of September 30, 2006.

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

Our management, including the CEO and CFO, does not expect that our Disclosure Controls or our 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

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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, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

Patent Infringement Complaint against Unaxis

On July 7, 2006, we filed a patent infringement lawsuit against Unaxis USA, Inc. and its affiliates Unaxis Balzers AG and Unaxis Balzers, Ltd. in the United States District Court for the Central District of California. Our lawsuit against Unaxis asserts infringement by Unaxis of United States Patent 6,919,001 that relates to our 200 Lean system. Our complaint seeks monetary damages and an injunction that bars Unaxis from making, using, offering to sell, or selling in the United States, or importing into the United States, the allegedly infringing product. In the suit, we seek damages and a permanent injunction for infringement of the same patent. We believe we have meritorious claims and we intend to pursue them vigorously.

On September 12, 2006 Unaxis filed a response to Intevac s lawsuit in which it asserted non-infringement, invalidity of the Intevac patent, inequitable conduct by Intevac, patent misuse by Intevac, and lack of jurisdiction by the court as defenses. Additionally, Unaxis requested a declaratory judgment of patent non-infringement, invalidity and unenforceability; asserted Intevac s violation of the California Business and Professional Code; requested that Intevac be enjoined from engaging in any unfair competition; and that Intevac be required to pay Unaxis attorney fees. We believe such claims lack merit and we intend to defend ourselves vigorously.

Other Legal Matters

From time to time, we are involved in claims and legal proceedings that arise in the ordinary course of business. We expect that the number and significance of these matters will increase as our 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. We are not presently party to any lawsuit or proceeding that, in our opinion, is likely to seriously harm our business.

Item 1A. *Risk Factors*

Our operating results fluctuate significantly from quarter to quarter, which may cause the price of our stock to decline.

Over the last 11 quarters, our revenues per quarter have fluctuated between $6.4 million and $59.5 million. Over the same period our operating income as a percentage of revenues has fluctuated between approximately 17% and (56%) of revenues. We anticipate that our revenues and operating margins will continue to fluctuate. We expect this fluctuation to continue for a variety of reasons, including:

changes in the demand, due to seasonality, cyclicality and other factors, for the computer systems, storage subsystems and consumer electronics containing disks our customers produce with our systems;

delays or problems in the introduction and acceptance of our new products, or delivery of existing products; and

announcements of new products, services or technological innovations by us or our competitors.

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Additionally, because our systems are priced in the millions of dollars and we sell a relatively small number of systems, our business is inherently subject to fluctuations in revenue from quarter to quarter due to factors such as timing of orders, acceptance of new systems by our customers or cancellation of those orders. As a result, we believe that quarter-to-quarter comparisons of our revenues and operating results may not be meaningful and that these comparisons may not be an accurate indicator of our future performance. Our operating results in one or more future quarters may fail to meet the expectations of investment research analysts or investors, which could cause an immediate and significant decline in the trading price of our common shares.

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 2005, one of our customers accounted for 41% of our revenues and four customers, in the aggregate, accounted for 90% of our revenues. These same four customers, in the aggregate, accounted for 93% of our net accounts receivable at December 31, 2005. To date in 2006, our results have been similarly concentrated. During 2005, Seagate announced its acquisition of Maxtor, which was completed in May 2006. This acquisition further consolidates our customer base, as they both are included in the four customers with whom our revenues and accounts receivable were heavily concentrated in 2005. Orders from a relatively limited number of magnetic disk manufacturers have accounted for, and likely will continue to account for, a substantial portion of our revenues. The loss of, or delays in purchasing by, any one of our large customers would significantly reduce, or delay, future revenues. The concentration of our customer base may enable customers to demand pricing and other terms unfavorable to us. Furthermore, the concentration of customers can lead to extreme variability in revenue and financial results from period to period. For example, during 2005 revenues ranged between $10.6 million in the first quarter and $52.7 million in the fourth quarter. These factors could have a material adverse effect on our business, financial condition and results of operations.

Our long-term revenue growth is dependent on new products. If these new products are not successful, then our results of operations will be adversely affected.

We have invested heavily, and continue to invest, in the development of new products. Our success in developing and selling new products depends upon a variety of factors, including our ability to predict future customer requirements accurately, technological advances, total cost of ownership of our systems, our introduction of new products on schedule, the reception our new products find in the market, our ability to manufacture our products cost-effectively and the performance of our products in the field. Our new product decisions and development commitments must anticipate continuously evolving industry requirements significantly in advance of sales.

The majority of our revenues in the twelve months ended December 31, 2005 was from sales of our 200 Lean disk sputtering system, which was first delivered in December 2003. When first introduced, advanced vacuum manufacturing equipment, such as the 200 Lean, is subject to extensive customer acceptance tests after installation at the customer s factory. These acceptance tests are designed to validate reliable operation to specification in areas such as throughput, vacuum level, robotics, process performance and software features and functionality. These tests are generally more comprehensive for new systems than for mature systems, and are designed to highlight problems encountered with early versions of the equipment. For example, initial builds of the 200 Lean experienced high production and warranty costs in comparison to our more established product lines. Failure to promptly address any of the problems uncovered in these tests could have adverse effects on our business, including rescheduling of backlog, failure to achieve customer acceptance and therefore revenue recognition as anticipated, unanticipated product rework and warranty costs, penalties for non-performance, cancellation of orders, or return of products for credit.

We are making a substantial investment to develop a new manufacturing system to address applications other than magnetic media manufacturing. We have not yet completed a fully functional production system, and do not expect to generate revenue from this product in the next twelve months. We spent $6.4 million, or 44% of our research and development costs, on this new product in 2005 and have significantly increased our level of spending on this project in 2006. We have not developed or sold products for this market previously, and our knowledge of the market and its needs is limited. Failure to correctly assess the size of the market, to successfully develop a product to

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cost-effectively address the market, or to establish effective sales and support of the new product would have a material adverse effect on our future revenues and profits, including loss of the Company s entire investment in the project.

We are jointly developing a next generation head mounted night-vision system with another defense contractor. This system is planned for sale to the U.S. military and will compete with head-mounted systems developed by our competitors. The US military does not intend to initiate production of this system until 2010. We plan to make a significant investment in this product and cannot be assured when, or if, we will be awarded any production contracts for these night vision systems.

Our LIVAR® target identification and low light level camera technologies are designed to offer significantly improved capability to military customers. We are also developing commercial products based on the technology we have developed in our Imaging business. None of our Imaging products are currently being manufactured in high volume, and we may encounter unforeseen difficulties when we commence volume production of these products. Our Imaging business will require substantial further investment in sales and marketing, in product development and in additional production facilities in order to expand our operations. We may not succeed in these activities or generate significant sales of these new products. To date, commercial sales of our commercial Imaging products have not been significant, and we do not expect to realize significant revenues in 2006 from deployment of LIVAR or our other Imaging products.

Failure of any of these new products to perform as intended, to penetrate their markets and develop into profitable product lines or to achieve their production cost objectives, would have a material adverse effect on our business.

Demand for capital equipment is cyclical, which subjects our business to long periods of depressed revenues interspersed with periods of unusually high revenues.

Our Equipment business sells equipment to capital-intensive industries, which sell commodity products such as disk drives. When demand for these commodity products exceeds capacity, demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of these commodity products exceeds demand, the demand for new capital equipment such as ours tends to be depressed. The hard disk drive industry has historically been subject to multi-year cycles because of the long lead times and high costs involved in adding capacity, and to seasonal cycles driven by consumer purchasing patterns, which tend to be heaviest in the third and fourth quarters of each year.

The cyclical nature of the capital equipment industry means that in some years we will have unusually high sales of new systems, and that in other years our sales of new systems will be severely depressed. The timing, length and volatility of these cycles are difficult to predict. These cycles have affected the timing and amounts of our customers capital equipment purchases and investments in new technology. For example, sales of systems for magnetic disk production were severely depressed from the middle of 1998 until mid-2003. We believe we are currently in a strong upswing in a cycle, but we cannot predict with any certainty how long such an upswing might last.

If the growth in demand for hard disk drives does not continue and our customers do not replace or upgrade their installed base of disk sputtering systems, then future sales of our disk sputtering systems will suffer.

From the middle of 1998 until mid-2003, there was very little demand for new disk sputtering systems, as magnetic disk manufacturers were burdened with over-capacity and were not investing in new disk sputtering equipment. By 2003, however, over-capacity had diminished and sales of our 200 Lean began to increase.

Sales of our equipment for capacity expansions are dependent on the capacity expansion plans of our customers and upon whether our customers select our equipment for their capacity expansions. We have no control over our

customers expansion plans, and we cannot assure you that they will select our equipment if they do expand their capacity. Our customers may not implement capacity expansion plans, or we may fail to win orders for equipment for those capacity expansions, which could have a material adverse effect on our business and our

operating results. In addition, some manufacturers may choose to purchase used systems from other manufacturers or customers rather than purchasing new systems from us. Furthermore, if hard disk drives were to be replaced by an alternative technology as a primary method of digital storage, demand for our products would decrease.

Sales of our 200 Lean disk sputtering systems are also dependent on obsolescence and replacement of the installed base of disk sputtering equipment. If technological advancements are developed that extend the useful life of the installed base of systems, then sales of our 200 Lean will be limited to the capacity expansion needs of our customers, which would significantly decrease our revenue.

Our products are complex, constantly evolving and often must be customized to individual customer requirements.

The systems we manufacture and sell in our Equipment business have a large number of components and are complex, which require us to make substantial investments in research and development. If we were to fail to develop, manufacture and market new systems or to enhance existing systems, that failure would have an adverse effect on our business. We may experience delays and technical and manufacturing difficulties in future introduction, volume production and acceptance of new systems or enhancements. In addition, some of the systems that we manufacture must be customized to meet individual customer site or operating requirements. In some cases, we market and commit to deliver new systems, modules and components with advanced features and capabilities that we are still in the process of designing. We have limited manufacturing capacity and engineering resources and may be unable to complete the development, manufacture and shipment of these products, or to meet the required technical specifications for these products, in a timely manner. Failure to deliver these products on time, or failure to deliver products that perform to all contractually committed specifications, could have adverse effects on our business, including rescheduling of backlog, failure to achieve customer acceptance and therefore revenue recognition as anticipated, unanticipated rework and warranty costs, penalties for non-performance, cancellation of orders, or return of products for credit. In addition, we may incur substantial unanticipated costs early in a product s life cycle, such as increased engineering, manufacturing, installation and support costs, that we may be unable to pass on to the customer and that may affect our gross margins. Sometimes we work closely with our customers to develop new features and products. In connection with these transactions, we sometimes offer a period of exclusivity to these customers.

Our sales cycle is long and unpredictable, which requires us to incur high sales and marketing expenses with no assurance that a sale will result.

The sales cycle for our equipment systems can be a year or longer, involving individuals from many different areas of our company and numerous product presentations and demonstrations for our prospective customers. Our sales process for these systems also includes the production of samples and customization of products for our prospective customers. We do not enter into long-term contracts with our customers and therefore, until an order is actually submitted by a customer, there is no binding commitment to purchase our systems.

Our Imaging business is also subject to long sales cycles because many of our products, such as our LIVAR system, often must be designed into our customers products, which are often complex state-of-the-art products. These development cycles are often multi-year, and our sales are contingent on our customer 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.

As a result, we may not recognize revenue from our products for extended periods of time after we have completed development, and made initial shipments of, our products, during which time we may expend substantial funds and management time and effort with no assurance that a sale will result.

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 competitors such as Anelva Corporation, which is a subsidiary of Canon, and Unaxis Holdings, Ltd, each of which has sold substantial numbers of systems worldwide. In the market for our Imaging products, we experience competition from

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companies such as ITT Industries, Inc. and Northrop Grumman Corporation, the primary U.S. manufacturers of Generation-III night vision devices and their derivative products. Our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do. We cannot assure you that our competitors will not develop enhancements to, or future generations of, competitive products that offer superior price or performance features. Likewise, we cannot assure you 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 experienced significant growth in our business and operations and if we do not appropriately manage this growth and any future growth, our operating results will be negatively affected.

Our business has grown significantly in recent years in both operations and headcount, and continued growth may cause a significant strain on our infrastructure, internal systems and managerial resources. To manage our growth effectively, we must continue to improve and expand our infrastructure, including information technology and financial operating and administrative systems and controls, and continue managing headcount, capital and processes in an efficient manner. Our productivity and the quality of our products may be adversely affected if we do not integrate and train our new employees quickly and effectively and coordinate among our executive, engineering, finance, marketing, sales, operations and customer support organizations, all of which add to the complexity of our organization and increase our operating expenses. We also may be less able to predict and effectively control our operating expenses due to the growth and increasing complexity of our business. In addition, our information technology systems may not grow at a sufficient rate to keep up with the processing and information demands placed on them by a much larger company. The efforts to continue to expand our information technology systems or our inability to do so could harm our business. Further, revenues may not grow at a sufficient rate to absorb the costs associated with a larger overall headcount.

Our future growth may require significant additional resources given that, as we increase our business operations in complexity and scale, we may have insufficient management capabilities and internal bandwidth to manage our growth and business effectively. We cannot assure you that resources will be available when we need them or that we will have sufficient capital to fund these potential resource needs. Also, growth in the number of orders received in our Equipment business may require additional physical space and headcount, and our ability to fulfill such orders may be constrained if we are unable to effectively grow our business. If we are unable to manage our growth effectively or if we experience a shortfall in resources, our results of operations will be harmed.

Our Imaging business depends heavily on government contracts, which are subject to immediate termination and are funded in increments. The termination of or failure to fund one or more of these contracts could have a negative impact on our operations.

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 $6.9 million, $8.2 million and $9.4 million in 2005, 2004 and 2003, respectively. Generally, government contracts are subject to oversight audits by government representatives and 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 assure you 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 assure you 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 assure you that we or our customers will continue to remain in good standing as federal contractors.

Furthermore, the 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. The loss of funding for a government program would result in a loss of anticipated future revenues attributable to that program. That could increase our overall costs of doing business.

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In addition, sales to the U.S. government and its prime contractors may be affected by changes in procurement policies, budget considerations and political developments in the United States or abroad. The influence of any of these factors, which are beyond our control, could also negatively impact our financial condition. We also may experience problems associated with advanced designs required by the government, which may result in unforeseen technological difficulties and cost overruns. Failure to overcome these technological difficulties and the occurrence of cost overruns would have a material adverse effect on our business.

We may not be successful in maintaining and obtaining the necessary export licenses to conduct operations abroad, and the United States government may prevent proposed sales to foreign customers.

Many of our Imaging products require export licenses from United States Government agencies under the Export Administration Act, the Trading with the Enemy Act of 1917, the Arms Export Act of 1976 and the International Trading in Arms Regulations. This limits the potential market for our products. We can give no assurance that we will be successful in obtaining all the licenses necessary to export our products. Recently, heightened government scrutiny of export licenses for products in our market has resulted in lengthened review periods for our license applications. For example, we have not yet received export approval for our Head-Mounted Night Vision camera to our NATO customer. Export to countries that are not considered by the United States Government to be allies is likely to be prohibited, and even sales to U.S. allies may be limited. Failure to obtain, or delays in obtaining, or revocation of previously issued licenses would prevent us from selling our products outside the United States, may subject us to fines or other penalties, and would have a material adverse effect on our business, financial condition and results of operations.

Unexpected increases in the cost to develop or manufacture our products under fixed-price contracts may cause us to experience un-reimbursed cost overruns.

A portion of our 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 materials costs, inefficiencies, or other factors, are borne by us. We have experienced cost overruns in the past that have resulted in losses on certain contracts, and may experience additional cost overruns in the future. We are required to recognize the total estimated impact of cost overruns in the period in which they are first identified. Such cost overruns would have a material adverse effect on our results of operations and financial condition.

Our sales of disk sputtering systems are dependent on substantial capital investment by our customers, far in excess of the cost of our products.

Our customers must make extremely large capital expenditures in order to purchase our systems and other related equipment and facilities. These costs are far in excess of the cost of our systems alone. The magnitude of such capital expenditures requires that our customers have access to large amounts of capital and that they be willing to invest that capital over long periods of time to be able to purchase our equipment. The magnetic disk manufacturing industry has not made significant additions to its production capacity until recently. Some of our potential customers may not be willing or able to make the magnitude of capital investment required, especially during a downturn in either the overall economy or the hard disk drive industry.

Our stock price is volatile.

The market price and trading volume of our common stock has been subject to significant volatility, and this trend may continue. Over the last 12 months, the closing price of our common stock, as traded on The Nasdaq National Market, fluctuated from a low of $8.88 to a high of $30.60 per share. The value of our common stock may decline

regardless of our operating performance or prospects. Factors affecting our market price include:

- our perceived prospects;
- hard disk drive market expectations;
- variations in our operating results and whether we achieve our key business targets;

sales or purchases of large blocks of our stock;

changes in, or our failure to meet, our revenue and earnings estimates;

changes in securities analysts buy or sell recommendations;

differences between our reported results and those expected by investors and securities analysts;

announcements of new contracts, products or technological innovations by us or our competitors;

market reaction to any acquisitions, joint ventures or strategic investments announced by us or our competitors;

our high fixed operating expenses, including research and development expenses;

developments in the financial markets; and

general economic, political or stock market conditions in the United States and other major regions in which we do business.

In addition, the general economic, political, stock market and hard drive industry conditions that may affect the market price of our common stock are beyond our control. The market price of our common stock at any particular time may not remain the market price in the future. 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 us, could result in substantial costs and a diversion of management s attention and resources.

Changes in tax rates or tax liabilities could affect future results.

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 tax rates could be affected by changes in the composition of earnings in countries with differing tax rates, changes in the valuation of our deferred tax assets and liabilities, or changes in the tax laws. Although we believe our tax estimates are reasonable, there can be no assurance that any final determination will not be materially different from the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our results of operations.

At December 31, 2005, due to a history of net operating losses prior to 2005, $15 million of deferred tax assets have been fully reserved by a valuation allowance. We are currently projecting an effective tax rate of 10% for 2006. This rate assumes the reversal of a portion of the valuation allowance against the deferred tax assets. If we determine that conclusive evidence exists to support additional adjustments to the valuation allowance, or we can reasonably forecast sufficient income to utilize the deferred tax assets, our future effective tax rate will likely increase significantly. An increase in the effective tax rate could have a material adverse effect on our reported earnings and earnings per share.

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

In the nine months ended September 30, 2006, approximately 86% of our revenues came from regions outside the United States. In 2005, approximately 71% of our revenues came from these regions. We currently have international customer support offices in Singapore, China, Malaysia, Korea and Japan. We expect that international sales will continue to account for a significant portion of our total revenue in future years. Certain manufacturing facilities and suppliers are also located outside the United States. Managing our global operations presents challenges including, but

not limited to, those arising from:

- varying regional and geopolitical business conditions and demands;
- global trade issues;
- variations in protection of intellectual property and other legal rights in different countries;
- rising raw material and energy costs;
- variations in the ability to develop relationships with suppliers and other local businesses;

changes in laws and regulations of the United States (including export restrictions) and other countries, as well as their interpretation and application;

fluctuations in interest rates and currency exchange rates;

the need to provide sufficient levels of technical support in different locations;

political instability, natural disasters (such as earthquakes, hurricanes or floods), pandemics, terrorism or acts of war where we have operations, suppliers or sales;

cultural differences; and

shipping delays.

Changes in existing financial accounting standards or practices or taxation rules or practices may adversely affect our results of operations.

Changes in existing accounting or taxation rules or practices, new accounting pronouncements or taxation rules, or varying interpretations of current accounting pronouncements or taxation practice could have a significant adverse effect on our results of operations or the manner in which we conduct our business. Further, such changes could potentially affect our reporting of transactions completed before such changes are effective. For example, in December 2004, the Financial Accounting Standards Board (FASB) enacted Statement of Financial Accounting Standards 123 (Revised 2004) (SFAS 123R), Share-Based Payment, which replaces SFAS No. 123 (SFAS 123), Accounting for Stock-Based Compensation. SFAS 123R requires the measurement of all share-based payments to employees, including grants of employee stock options, using a fair-value-based method and the recording of such compensation expense in our statements of income. We adopted SFAS 123R in the first quarter of fiscal year 2006. In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48, which will be effective January 1, 2007, clarifies the accounting for uncertainty in income taxes recognized in an enterprise s financial statements in accordance with FASB Statement No. 109, Accounting for Income Taxes. The adoption of FIN 48 may have a material impact on our consolidated financial position, results of operations and cash flows.

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, our management must perform evaluations of our internal control over financial reporting. Beginning in 2004, our Form 10-K has included a report by management of their assessment of the adequacy of such internal control. Additionally, our independent registered public accounting firm must publicly attest to the adequacy of management s assessment and the effectiveness of our internal control. Ongoing compliance with these requirements is complex, costly and time-consuming.

In 2004, we were not able to assert, in our management certifications filed with our Annual Report on Form 10-K, that our internal control over financial reporting was effective as of December 31, 2004, as our management identified three material weaknesses in our internal control over financial reporting. Any future inability to assert that our internal controls over financial reporting are effective for any given reporting period (or if our auditors are unable to attest that our management s report is fairly stated or if they are unable to express an opinion on the effectiveness of our internal controls), could cause us to lose investor confidence in the accuracy and completeness of our financial

reports, which could have an adverse effect on our stock price.

We have in the past discovered, and may in the future discover, areas of our internal controls that need improvement. During the 2004 audit, our external auditors brought to our attention a need to increase the internal controls in certain areas of our operation, including revenue calculations in the Imaging business, determination of inventory reserve requirements, approval of changes to the perpetual inventory and segregation of duties. In 2005, we devoted significant resources to remediation of these and other findings and to improvement of our internal controls. Although we believe that these efforts have strengthened our internal controls and addressed the concerns

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that gave rise to the material weaknesses previously reported by us, we are continuing to work to improve our internal controls.

Our dependence on suppliers for certain parts, some of them sole-sourced, makes us vulnerable to manufacturing interruptions and delays, which could affect our ability to meet customer demand.

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 or increased costs to expedite deliveries or develop alternative suppliers. Development of alternative suppliers could require redesign of our products.

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

The success of our business depends upon integrity of our intellectual property rights and we cannot assure you that:

- 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;
- any of our patents will not be invalidated, deemed unenforceable, circumvented or challenged;
- the rights granted under our patents will provide competitive advantages to us;
- other parties will not develop similar products, duplicate our products or design around our patents; or
- our patent rights, intellectual property laws or our agreements will adequately protect our intellectual property or competitive position.

Failure to protect our intellectual property rights adequately could have a material adverse effect on our business.

We provide products that are expected to have long useful lives and that are critical to our customers operations. From time to time, as part of business agreements, we place portions of our intellectual property into escrow to provide assurance to our customers that our technology will be available to them in the event that we are unable to support them at some point in the future.

From time to time, we have received claims that we are infringing third parties intellectual property rights. We cannot assure you 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.

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 and other restrictions.

Our U.S. operations are located in Santa Clara, California and Fremont, California, where the cost of living and 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 similar industries, such as the semiconductor industry, for the same pool of skilled employees. If we are unable to retain key personnel, or if we are not able to attract, assimilate or retain

additional highly qualified employees to meet our needs in the future, our business and operations could be harmed. Changes we make to our business in response to the adoption of 123R may make this more difficult.

Changes in demand caused by fluctuations in interest and currency exchange rates may reduce our international sales.

Sales and operating activities outside of the United States are subject to inherent risks, including fluctuations in the value of the U.S. dollar relative to foreign currencies, tariffs, quotas, taxes and other market barriers, political and economic instability, restrictions on the export or import of technology, potentially limited intellectual property protection, difficulties in staffing and managing international operations and potentially adverse tax consequences. We earn a significant portion of our revenue from international sales, and there can be no assurance that any of these factors will not have an adverse effect on our ability to sell our products or operate outside the United States.

We currently quote and sell the majority of our products in U.S. dollars. From time to time, we may enter into foreign currency contracts in an effort to reduce the overall risk of currency fluctuations to our business. However, there can be no assurance that the offer and sale of products denominated in foreign currencies, and the related foreign currency hedging activities, will not adversely affect our business.

Our principal competitor for disk sputtering equipment is based in Japan and has a cost structure based on the Japanese yen. Accordingly, currency fluctuations could cause the price of our products to be more or less competitive than our principal competitor s products. Currency fluctuations will decrease or increase our cost structure relative to those of our competitors, which could lessen the demand for our products and affect our competitive position.

We may evaluate acquisition candidates and other diversification strategies.

In the past we have engaged in acquisitions as part of our efforts to expand and diversify our business. For example, our business was initially acquired from Varian Associates in 1991. We also acquired our gravity lubrication and rapid thermal processing product lines in two acquisitions. We sold the rapid thermal processing product line in November 2002. We also acquired our RPC electron beam processing business in late 1997, and subsequently closed this business. We intend to continue to evaluate new acquisition candidates, divestiture and diversification strategies. Any acquisition involves numerous risks, including difficulties in the assimilation of the acquired company s employees, operations and products, uncertainties associated with operating in new markets and working with new customers, and the potential loss of the acquired company s key employees. Additionally, unanticipated expenses, difficulties and consequences may be incurred relating to the integration of technologies, research and development, and administrative and other functions. Any future acquisitions may 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. Failure to properly manage the use, disposal or storage of, or adequately restrict the release of, hazardous or toxic substances could subject us to significant liabilities.

Future sales of shares of our common stock by our officers, directors and affiliates could cause our stock price to decline.

Substantially all of our common stock may be sold without restriction in the public markets, although shares held by our directors, executive officers and affiliates may be subject to volume and manner of sale restrictions. In

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August 2005, at the request of Redemco LLC, we registered the sale of 2,000,000 shares at any time and in any manner Redemco LLC chooses. As of March 20, 2006, Redemco LLC had sold all these 2,000,000 shares, and Redemco LLC and its affiliates still owned 1,004,000 shares. Redemco LLC and its affiliates can resell these remaining shares at any time without restrictions. Sales of a substantial number of shares of common stock in the public market by our officers, directors or affiliates or the perception that these sales could occur could materially and adversely affect our stock price and make it more difficult for us to sell equity securities in the future at a time and price we deem appropriate.

Anti-takeover provisions in our charter documents and under California law could prevent or delay a change in control, which could negatively impact the value of our common stock by discouraging a favorable merger or acquisition of us.

Our articles of incorporation authorize our board of directors to issue up to 10,000,000 shares of preferred stock and to determine the powers, preferences, privileges, rights, including voting rights, qualifications, limitations and restrictions of those shares, without any further vote or action by the shareholders. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that we may issue in the future. The issuance of preferred stock could have the effect of delaying, deterring or preventing a change in control and could adversely affect the voting power of your shares. In addition, provisions of California law and our bylaws could make it more difficult for a third party to acquire a majority of our outstanding voting stock by discouraging a hostile bid, or delaying or deterring a merger, acquisition or tender offer in which our shareholders could receive a premium for their shares or a proxy contest for control of our company or other changes in our management.

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, we recently filed a patent infringement suit against Unaxis. Litigation tends to be expensive and requires significant management time and attention and could have a negative effect on our results of operations or business if we lose or have to settle a case on significantly adverse terms.

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 fully implemented 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 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 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 an earthquake, but there is no certainty that our efforts will prove successful in the event of an earthquake.

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

None.

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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
31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification Pursuant to U.S.C. 1350 adopted Pursuant to Section 906 of the Sarbanes- Oxley Act of 2002.

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: November 8, 2006 By: /s/ KEVIN FAIRBAIRN
Kevin Fairbairn
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: November 8, 2006 By: /s/ CHARLES B. EDDY III
Charles B. Eddy III
Vice President, Finance and Administration,
Chief Financial Officer, Treasurer and Secretary
(Principal Financial and Accounting Officer)

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