

INTEVAC INC
Form 10-Q
August 02, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended July 2, 2016

OR

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

For the transition period from _____ to _____

Commission file number 0-26946

INTEVAC, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

94-3125814
(IRS Employer
Identification No.)

3560 Bassett Street

Santa Clara, California 95054

(Address of principal executive office, including Zip Code)

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

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

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

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

Large accelerated filer Accelerated filer

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

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

On August 2, 2016, 20,923,678 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

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INTEVAC, INC.

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

	July 2, 2016	January 2, 2016
	(Unaudited)	
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 18,733	\$ 13,746
Short-term investments	16,655	23,208
Trade and other accounts receivable, net of allowances of \$0 at both July 2, 2016 and at January 2, 2016	16,808	12,310
Inventories	22,487	18,760
Prepaid expenses and other current assets	1,621	1,712
Total current assets	76,304	69,736
Property, plant and equipment, net	11,727	11,921
Long-term investments	5,226	9,673
Restricted cash	1,780	1,780
Intangible assets, net of amortization of \$5,702 at July 2, 2016 and \$5,275 at January 2, 2016	2,685	3,112
Deferred income taxes and other long-term assets	945	1,459
Total assets	\$ 98,667	\$ 97,681
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 4,040	\$ 5,950
Accrued payroll and related liabilities	4,321	4,066
Other accrued liabilities	3,617	5,632
Customer advances	14,979	3,625
Total current liabilities	26,957	19,273
Other long-term liabilities	2,883	2,411
Stockholders' equity:		
Common stock, \$0.001 par value	21	20
Additional paid-in capital	169,059	166,514

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Treasury stock, 4,845 shares at July 2, 2016 and January 2, 2016	(28,489)	(28,489)
Accumulated other comprehensive income	491	412
Accumulated deficit	(72,255)	(62,460)
Total stockholders' equity	68,827	75,997
Total liabilities and stockholders' equity	\$ 98,667	\$ 97,681

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

See accompanying notes.

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

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(Unaudited)			
	(In thousands, except per share amounts)			
Net revenues:				
Systems and components	\$ 13,083	\$ 18,646	\$ 26,364	\$ 36,728
Technology development	1,835	1,812	2,218	3,615
Total net revenues	14,918	20,458	28,582	40,343
Cost of net revenues:				
Systems and components	7,514	11,487	16,465	23,072
Technology development	1,277	1,165	2,135	2,544
Total cost of net revenues	8,791	12,652	18,600	25,616
Gross profit	6,127	7,806	9,982	14,727
Operating expenses:				
Research and development	4,977	2,947	10,154	7,555
Selling, general and administrative	4,957	4,576	9,952	9,829
Total operating expenses	9,934	7,523	20,106	17,384
Income (loss) from operations	(3,807)	283	(10,124)	(2,657)
Interest income and other income (expense), net	87	(13)	125	66
Income (loss) before income taxes	(3,720)	270	(9,999)	(2,591)
Provision for (benefit from) income taxes	(230)	258	(204)	290
Net income (loss)	\$ (3,490)	\$ 12	\$ (9,795)	\$ (2,881)
Net income (loss) per share:				
Basic and diluted	\$ (0.17)	\$	\$ (0.48)	\$ (0.13)
Weighted average common shares outstanding:				
Basic	20,691	22,630	20,621	22,929
Diluted	20,691	22,912	20,621	22,929

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(Unaudited)			
	(In thousands)			
Net income (loss)	\$ (3,490)	\$ 12	\$ (9,795)	\$ (2,881)
Other comprehensive income (loss), before tax:				
Change in unrealized net gain on available-for-sale investments	13	(4)	57	25
Foreign currency translation gains (losses)	(45)	(35)	22	(35)
Other comprehensive income (loss), before tax	(32)	(39)	79	(10)
Income taxes related to items in other comprehensive income (loss)				
Other comprehensive income (loss), net of tax	(32)	(39)	79	(10)
Comprehensive loss	\$ (3,522)	\$ (27)	\$ (9,716)	\$ (2,891)

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended	
	July 2,	July 4,
	2016	2015
	(Unaudited)	
	(In thousands)	
Operating activities		
Net loss	\$ (9,795)	\$ (2,881)
Adjustments to reconcile net loss to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	2,658	2,324
Net amortization of investment premiums and discounts	63	200
Equity-based compensation	1,991	1,663
Change in the fair value of acquisition-related contingent consideration	(142)	(200)
Deferred income taxes	9	(10)
Loss on disposal of equipment		91
Changes in operating assets and liabilities	911	(922)
Total adjustments	5,490	3,146
Net cash and cash equivalents provided by (used in) operating activities	(4,305)	265
Investing activities		
Purchases of investments	(7,736)	(16,097)
Proceeds from sales and maturities of investments	18,730	20,200
Proceeds from sale of equipment		11
Purchases of leasehold improvements and equipment	(2,039)	(1,534)
Net cash and cash equivalents provided by investing activities	8,955	2,580
Financing activities		
Net proceeds from issuance of common stock	715	910
Common stock repurchases		(8,868)
Taxes paid related to net share settlement	(401)	(117)
Net cash and cash equivalents provided by (used in) financing activities	314	(8,075)
Effect of exchange rate changes on cash and cash equivalents	23	(35)
Net increase (decrease) in cash and cash equivalents	4,987	(5,265)
Cash and cash equivalents at beginning of period	13,746	21,482
Cash and cash equivalents at end of period	\$ 18,733	\$ 16,217

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

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

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

2. Recent Accounting Pronouncements

In February 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2016-02, *Leases (Topic 842)*, which amends the existing guidance to require lessees to recognize lease assets and lease liabilities arising from operating leases in a classified balance sheet. The requirements of this ASU are effective for interim and annual reporting periods beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact that ASU 2016-02 will have on our consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, *Compensation - Stock Compensation (Topic 718)*. This ASU makes several modifications to Topic 718 related to the accounting for forfeitures, employer tax withholding on share-based compensation and the financial statement presentation of excess tax benefits or deficiencies. The requirements of this ASU are effective for interim and annual reporting periods beginning after December 15, 2016, although early adoption is permitted. We are currently assessing how the adoption of this standard will impact our consolidated financial statements.

The FASB has issued several more amendments to the new revenue standard ASU 2014-09, as amended by ASU 2015-14:

March 2016 ASU 2016-08, *Revenue from Contracts with Customers (Topic 606): Principal versus Agent Considerations (Reporting Revenue Gross versus Net)*. ASU 2016-08 clarifies the implementation guidance on principal versus agent considerations. The guidance includes indicators to assist an entity in determining whether it controls a specified good or service before it is transferred to customers.

April 2016 ASU 2016-10, *Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing*. ASU 2016-10 covers two specific topics: performance obligations and licensing. This ASU includes guidance on immaterial promised goods or services, shipping or handling activities, separately identifiable performance obligations, functional or symbolic intellectual property licenses, sales-based and usage-based royalties, license restrictions (time, use, geographical) and licensing renewals.

May 2016 ASU 2016-12, *Revenue from Contracts with Customers (Topic 606): Narrow Scope Improvements and Practical Expedients*. ASU 2016-12 clarifies certain core recognition principles including collectability, sales tax presentation, noncash consideration, contract modifications and completed contracts at transition and disclosures no longer required if the full retrospective transition method is adopted.

We are currently assessing how the adoption of these new standards will impact our consolidated financial statements.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In June 2016, the FASB issued ASU 2016-13, *Financial Instruments - Credit Losses (Topic 326)*. This ASU amends the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in the more timely recognition of losses. The requirements of this ASU are effective for interim and annual reporting periods beginning after December 15, 2019. We are currently assessing how the adoption of this standard will impact our consolidated financial statements.

3. Inventories

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

	July 2, 2016	January 2, 2016
	(In thousands)	
Raw materials	\$ 10,718	\$ 11,081
Work-in-progress	9,706	4,365
Finished goods	2,063	3,314
	\$ 22,487	\$ 18,760

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

4. Equity-Based Compensation

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

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

Compensation Expense

The effect of recording equity-based compensation for the three and six months ended July 2, 2016 and July 4, 2015 was as follows:

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(In thousands)			
Equity-based compensation by type of award:				
Stock options	\$ 209	\$ 125	\$ 485	\$ 442
RSUs	480	395	1,114	735
Employee stock purchase plan	191	280	392	486
Total equity-based compensation	\$ 880	\$ 800	\$ 1,991	\$ 1,663

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

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Stock Options and ESPP

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

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

	Shares	Weighted Average Exercise Price
Options outstanding at January 2, 2016	2,433,647	\$ 7.52
Options granted	394,750	\$ 4.79
Options cancelled and forfeited	(63,799)	\$ 12.89
Options exercised	(975)	\$ 4.58
Options outstanding at July 2, 2016	2,763,623	\$ 7.01
Vested and expected to vest at July 2, 2016	2,604,501	\$ 7.11
Options exercisable at July 2, 2016	1,739,195	\$ 7.82

Intevac issued 187,214 shares under the ESPP during the six months ended July 2, 2016.

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

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
Stock Options:				
Weighted-average fair value of grants per share	\$ 1.75	\$ 2.05	\$ 1.74	\$ 2.07
Expected volatility	44.14%	46.13%	44.11%	46.26%
Risk free interest rate	0.94%	1.44%	0.94%	1.43%
Expected term of options (in years)	4.3	4.0	4.3	4.0
Dividend yield	None	None	None	None

	Six Months Ended	
	July 2, 2016	July 4, 2015
Stock Purchase Rights:		
Weighted-average fair value of grants per share	\$ 1.54	\$ 2.26
Expected volatility	39.33%	44.05%
Risk free interest rate	0.76%	0.39%
Expected term of purchase rights (in years)	1.93	1.22
Dividend yield	None	None

The computation of the expected volatility assumptions used in the Black-Scholes calculations for new stock option grants and purchase rights is based on the historical volatility of Intevac's stock price, measured over a period

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

RSUs

A summary of the RSU activity is as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested RSUs at January 2, 2016	553,584	\$ 6.16
Granted	754,652	\$ 4.17
Vested	(257,007)	\$ 6.49
Cancelled and forfeited	(83,079)	\$ 4.70
Non-vested RSUs at July 2, 2016	968,150	\$ 4.64

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

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

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

	Six Months Ended	
	July 2, 2016	
Weighted-average fair value of grants per share	\$	2.46
Expected volatility		47.65%
Risk free interest rate		1.35%
Expected term (in years)		4.79
Dividend yield		None

In fiscal 2016 and fiscal 2015, the annual bonus for certain participants in the Company's annual incentive plan will be settled with RSUs with one year vesting. The Company accrued for the payment of bonuses at the expected

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

company-wide payout percentage amount at July 2, 2016 and July 4, 2015, which amounts were less than the target bonus amounts for each participant. The bonus accrual is classified as a liability until the number of shares is determined on the date the awards are granted, at which time the Company classifies the awards into equity. In February 2016, the annual 2015 bonus for certain participants was settled with RSUs with one year vesting. 34 participants were granted stock awards to receive 266,000 shares of common stock with a weighted average grant date fair value of \$4.40 per share. In February 2015, the 2014 annual bonus for certain participants was settled with RSUs with one year vesting. 29 participants were granted stock awards to receive 133,000 shares of common stock with a weighted average grant date fair value of \$6.85 per share. The Company recorded equity-based compensation expense related to the annual incentive plan of \$129,000 and \$243,000, respectively, for the three and six months ended July 2, 2016 and \$123,000 and \$72,000, respectively, for the three and six months ended July 4, 2015.

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

5. Purchased Intangible Assets

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

	July 2, 2016	
Gross Carrying Amount	Accumulated Amortization (In thousands)	Net Carrying Amount

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Thin-film Equipment	\$ 7,172	\$ (4,757)	\$ 2,415
Photonics	1,215	(945)	270
	\$ 8,387	\$ (5,702)	\$ 2,685

Total amortization expense of finite-lived intangibles for the three and six months ended July 2, 2016 was \$213,000 and \$427,000.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

(In thousands)	
2016	\$ 427
2017	754
2018	615
2019	615
2020	274
	\$ 2,685

6. Acquisition-Related Contingent Consideration

In connection with the acquisition of Solar Implant Technologies, Inc. (SIT), Intevac agreed to pay to the selling shareholders in cash a revenue earnout on Intevac's net revenue from commercial sales of certain products over a specified period up to an aggregate of \$9.0 million. Intevac estimated the fair value of this contingent consideration on July 2, 2016 based on probability-based forecasted revenues reflecting Intevac's own assumptions concerning future revenue from such products. As of July 2, 2016, payments made associated with the revenue earnout obligation have not been significant.

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

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
(In thousands)				
Opening balance	\$ 906	\$ 1,108	\$ 890	\$ 1,134
Changes in fair value	(158)	(174)	(142)	(200)
Closing balance	\$ 748	\$ 934	\$ 748	\$ 934

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

	July 2, 2016	January 2, 2016
	(In thousands)	
Other accrued liabilities	\$ 106	\$ 179
Other long-term liabilities	642	711
Total acquisition-related contingent consideration	\$ 748	\$ 890

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
(In thousands, except for percentages)			
Revenue \$ 748	Discounted cash flow	Weighted average cost of capital	13.5%
Earnout		Probability weighting of achieving revenue forecasts	10.0% - 80.0% (30.3%)

7. Warranty

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

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

The following table displays the activity in the warranty provision account for the three and six months ended July 2, 2016 and July 4, 2015:

Three Months Ended		Six Months Ended	
July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015

	(In thousands)			
Opening balance	\$ 776	\$ 1,352	\$ 982	\$ 1,186
Expenditures incurred under warranties	(106)	(91)	(303)	(222)
Accruals for product warranties issued during the reporting period	61	203	174	600
Adjustments to previously existing warranty accruals	(139)	(186)	(261)	(286)
Closing balance	\$ 592	\$ 1,278	\$ 592	\$ 1,278

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

	July 2, 2016	January 2, 2016
	(In thousands)	
Other accrued liabilities	\$ 543	\$ 835
Other long-term liabilities	49	147
Total warranty provision	\$ 592	\$ 982

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

8. Guarantees*Officer and Director Indemnifications*

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

Other Indemnifications

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

Letters of Credit

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

9. Cash, Cash Equivalents and Investments

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

Amortized Cost	July 2, 2016		Fair Value
	Unrealized Holding Gains	Unrealized Holding Losses	
	(In thousands)		

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Cash and cash equivalents:				
Cash	\$ 9,442	\$	\$	\$ 9,442
Money market funds	9,291			9,291
Total cash and cash equivalents	\$ 18,733	\$	\$	\$ 18,733
Short-term investments:				
Commercial paper	\$ 1,091	\$	\$ 1	\$ 1,090
Corporate bonds and medium-term notes	6,651	3	1	6,653
Municipal bonds	3,135	1		3,136
U.S. treasury and agency securities	5,773	4	1	5,776
Total short-term investments	\$ 16,650	\$ 8	\$ 3	\$ 16,655
Long-term investments:				
Corporate bonds and medium-term notes	\$ 5,214	\$ 12	\$	\$ 5,226
Total long-term investments	\$ 5,214	\$ 12	\$	\$ 5,226
Total cash, cash equivalents, and investments	\$ 40,597	\$ 20	\$ 3	\$ 40,614

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

	Amortized Cost	Fair Value
	(In thousands)	
Due in one year or less	\$ 25,941	\$ 25,946
Due after one through two years	5,214	5,226
	\$ 31,155	\$ 31,172

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

	July 2, 2016			
	In Loss Position for Less than 12 Months		In Loss Position for Greater than 12 Months	
	Gross Unrealized		Gross Unrealized	
	Fair Value	Losses	Fair Value	Losses
	(In thousands)			
Commercial paper	\$ 1,090	\$ 1	\$	\$
Corporate bonds and medium-term notes	3,214	1		
U.S. treasury and agency securities	1,271	1		
	\$ 5,575	\$ 3	\$	\$

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

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

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

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

	Fair Value Measurements at July 2, 2016		
	Total	Level 1	Level 2
	(In thousands)		
Recurring fair value measurements:			
Available-for-sale securities			
Money market funds	\$ 9,291	\$ 9,291	\$
U.S. treasury and agency securities	5,776	3,501	2,275
Commercial paper	1,090		1,090
Corporate bonds and medium-term notes	11,879		11,879
Municipal bonds	3,136		3,136
Total recurring fair value measurements	\$ 31,172	\$ 12,792	\$ 18,380

10. Derivative Instruments

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

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

Derivative Instrument	Notional Amounts		Derivative Assets		Derivative Liabilities	
	July 2, 2016	January 2, 2016	July 2, 2016	January 2, 2016	July 2, 2016	January 2, 2016
			Balance Sheet Line Value	Balance Sheet Fair Value	Balance Sheet Line Value	Balance Sheet Fair Value
			(in thousands)			
Undesignated Hedges:						
Forward Foreign Currency Contracts	\$ 910	\$ 924	(a) \$	(a) \$ 1	(b) \$ 6	(b) \$ 4
Total Hedges	\$ 910	\$ 924	\$	\$ 1	\$ 6	\$ 4

(a) Prepaid expenses and other current assets

(b) Other accrued liabilities

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

The following table summarizes Intevac's stock repurchases:

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(In thousands, except per share amounts)			
Shares of common stock repurchased		1,128		1,571
Cost of stock repurchased	\$	\$ 6,293	\$	\$ 9,280
Average price paid per share	\$	\$ 5.55	\$	\$ 5.88

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

Accumulated Other Comprehensive Income

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

	Three Months Ended			Six Months Ended		
	July 2, 2016			July 4, 2015		
	Unrealized	Unrealized		Unrealized	Unrealized	
	holding	holding		holding	holding	
	gains on	gains on		gains on	gains on	
	available-	available-		available-	available-	
	for-sale	for-sale		for-sale	for-sale	
	Foreign	Foreign		Foreign	Foreign	
	currency	currency		currency	currency	
	investments	investments		investments	investments	
	Total	Total		Total	Total	
	(In thousands)					
Beginning balance	\$ 519	\$ 4	\$ 523	\$ 452	\$ (40)	\$ 412

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Other comprehensive income (loss) before reclassification	(45)	13	(32)	22	57	79
Amounts reclassified from other comprehensive income						
Net current-period other comprehensive income (loss)	(45)	13	(32)	22	57	79
Ending balance	\$ 474	\$ 17	\$ 491	\$ 474	\$ 17	\$ 491

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	Three Months Ended July 4, 2015			Six Months Ended July 4, 2015		
	Unrealized holding gains on available- Foreign currency	for-sale investments	Total	Unrealized holding gains on available- Foreign currency	for-sale investments	Total
	(In thousands)					
Beginning balance	\$ 620	\$ 28	\$ 648	\$ 620	\$ (1)	\$ 619
Other comprehensive income (loss) before reclassification	(35)	(4)	(39)	(35)	25	(10)
Amounts reclassified from other comprehensive income						
Net current-period other comprehensive income (loss)	(35)	(4)	(39)	(35)	25	(10)
Ending balance	\$ 585	\$ 24	\$ 609	\$ 585	\$ 24	\$ 609

12. Net Income (Loss) Per Share

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

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(In thousands, except per share amounts)			
Net income (loss)	\$ (3,490)	\$ 12	\$ (9,795)	\$ (2,881)
Weighted-average shares basic	20,691	22,630	20,621	22,929
Effect of dilutive potential common shares		282		
Weighted-average shares diluted	20,691	22,912	20,621	22,929
Net loss per share basic and diluted	\$ (0.17)	\$	\$ (0.48)	\$ (0.13)

The following potentially dilutive securities were excluded (as common stock equivalents) from the computation of diluted net income (loss) per share for the periods presented as their effect would have been antidilutive:

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(In thousands)			
Stock options to purchase common stock	2,764	2,309	2,764	2,646
RSUs	968	43	968	552
Employee stock purchase plan	180		180	162

13. Segment Reporting

Intevac's two reportable segments are: Thin-film Equipment and Photonics. Effective in the first quarter of 2015, Intevac renamed the Equipment segment Thin-film Equipment. Intevac's chief operating decision-maker has been identified as the President and CEO, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon Intevac's management organization structure as of July 2, 2016 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

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

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

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

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

Net Revenues

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(In thousands)			
Thin-film Equipment	\$ 6,088	\$ 11,494	\$ 11,668	\$ 22,122
Photonics	8,830	8,964	16,914	18,221
Total segment net revenues	\$ 14,918	\$ 20,458	\$ 28,582	\$ 40,343

Operating Income (Loss)

	Three Months Ended		Six Months Ended	
	July 2, 2016	July 4, 2015	July 2, 2016	July 4, 2015
	(In thousands)			
Thin-film Equipment	\$ (3,674)	\$ 6	\$ (9,119)	\$ (3,291)
Photonics	1,512	1,275	1,919	2,752
Total income (loss) from segment operations	(2,162)	1,281	(7,200)	(539)
Unallocated costs	(1,645)	(998)	(2,924)	(2,118)
Income (loss) from operations	(3,807)	283	(10,124)	(2,657)
Interest income and other income (expense), net	87	(13)	125	66
Income (loss) before income taxes	\$ (3,720)	\$ 270	\$ (9,999)	\$ (2,591)

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

Assets

	July 2, 2016	January 2, 2016
	(In thousands)	
Thin-film Equipment	\$ 36,278	\$ 29,528
Photonics	15,479	16,029
Total segment assets	51,757	45,557
Cash, cash equivalents and investments	40,614	46,627
Restricted cash	1,780	1,780
Deferred income taxes	3	12
Other current assets	1,147	1,052
Common property, plant and equipment	2,447	1,218
Other assets	919	1,435
Consolidated total assets	\$ 98,667	\$ 97,681

14. Restructuring Charges

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

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

**July 4,
2015**

	Severance and other employee- related costs (In thousands)
Beginning balance	\$
Provision for restructuring reserves	148
Cash payments made	(148)
Ending balance	\$

15. Income Taxes

Intevac recorded income tax benefits of \$230,000 and \$204,000 for the three and six months ended July 2, 2016, respectively, and tax provisions of \$258,000 and \$290,000 for the three and six months ended July 4, 2015, respectively. Intevac recorded the following discrete items for audit considerations in foreign jurisdictions: a \$281,000 income tax benefit during the three months ended July 2, 2016 and a \$262,000 income tax charge during the three months ended July 4, 2015. The income tax provisions (benefits) for the three and six month periods are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the

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

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

The Inland Revenue Authority of Singapore (IRAS) is currently conducting a review of the fiscal 2009 through 2012 tax returns of the Company's wholly-owned subsidiary, Intevac Asia Pte. Ltd. IRAS has challenged the Company's tax position with respect to certain aspects of the Company's transfer pricing. Under Singapore tax law, the Company must pay all contested taxes and the related interest to have the right to defend its position. As a result, the Company made deposits of \$318,000 for the 2009 tax year in fiscal 2014 and \$1.1 million for the 2010 tax year in fiscal 2015, respectively. In June 2016, IRAS allowed the deduction of a portion of the challenged deductions and the Company received a partial refund of \$517,000 of the contested taxes. Accordingly, the Company derecognized a portion of the tax accrual of approximately \$281,000 by reducing the income tax provision by \$281,000. The contested tax deposits of \$919,000 and \$1.4 million are included in other long-term assets at July 2, 2016 and January 2, 2016, respectively, on the condensed consolidated balance sheets. The ultimate outcome of this examination is subject to uncertainty. The Company's management and its advisors continue to believe that the Company is more likely than not to successfully defend that the tax treatment was proper and in accordance with Singapore tax regulations. Based on the information currently available, the Company does not anticipate a significant increase or decrease to its unrecognized tax benefits for this matter within the next twelve months. We believe that adequate amounts have been reserved for any adjustments that may ultimately result from this or other examinations. Presently, there are no other active income tax examinations in the jurisdictions where Intevac operates.

16. Contingencies

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

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

This Quarterly Report on Form 10-Q contains forward-looking statements, which involve risks and uncertainties. Words such as believes, expects, anticipates and the like indicate forward-looking statements. These forward-looking statements include comments related to Intevac's shipments, projected revenue recognition, product costs, gross margin, operating expenses, interest income, income taxes, cash balances and financial results in 2016 and beyond; projected customer requirements for Intevac's new and existing products, and when, and if, Intevac's customers will place orders for these products; Intevac's ability to proliferate its Photonics technology into major military programs and to develop and introduce commercial imaging products; the timing of delivery and/or acceptance of the systems and products that comprise Intevac's backlog for revenue and the Company's ability to achieve cost savings. Intevac's actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under Risk Factors and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed on February 17, 2016, and our periodic Form 10-Q's and Form 8-K's.

Overview

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

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

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

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

	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
	(In thousands, except percentages and per share amounts)					
Net revenues	\$ 14,918	\$ 20,458	\$ (5,540)	\$ 28,582	\$ 40,343	\$ (11,761)
Gross profit	\$ 6,127	\$ 7,806	\$ (1,679)	\$ 9,982	\$ 14,727	\$ (4,745)
Gross margin percent	41.1%	38.2%	2.9 points	34.9%	36.5%	(1.6) points
Income (loss) from operations	\$ (3,807)	\$ 283	\$ (4,090)	\$ (10,124)	\$ (2,657)	\$ (7,467)
Net income (loss)	\$ (3,490)	\$ 12	\$ (3,502)	\$ (9,795)	\$ (2,881)	\$ (6,914)
Net income (loss) per diluted share	\$ (0.17)	\$	\$ (0.17)	\$ (0.48)	\$ (0.13)	\$ (0.35)

Net revenues for the second quarter of fiscal 2016 decreased compared to the same period in the prior year primarily due to lower equipment sales to disk manufacturers and by lower Photonics product sales. Lower net income for the second quarter of fiscal 2016 compared to the same period in the prior year is due to lower revenue, lower gross profits and higher operating expenses. Lower operating costs in the second quarter of fiscal 2015 reflected costs recovered under a Non-Recurring Engineering (NRE) arrangement.

Net revenues for the first six months of fiscal 2016 decreased compared to the same period in the prior year primarily due to lower equipment sales to disk manufacturers and lower Photonics contract R&D. Thin-film Equipment recognized revenue in both the first half of fiscal 2016 and the first half of fiscal 2015 on one VERTEX coating system for DCPs. Intevac recognized revenue on one 200 Lean system in the first half of fiscal 2015. The net loss for the first six months of fiscal 2016 increased compared to the same period in the prior year due to lower revenues, lower gross margins and higher operating expenses.

In fiscal 2016, although our hard disk drive customers experienced increased demand from enterprise data storage and nearline cloud applications, Intevac expects that our hard disk drive customers media production capacity will continue to exceed demand. The Company expects that shipments of Intevac equipment to hard disk drive manufacturers will be similar to 2015 levels. In 2016, Intevac expects higher sales of new thin-film equipment products as Intevac delivers the initial production shipments of our coating system for DCPs and as solar cell manufacturers begin to adopt new vacuum technologies in the manufacturing of solar cells. For fiscal 2016, Intevac expects that Photonics business levels will be about the same as 2015 as Photonics continues to deliver production shipments of the pilot night vision systems for the Apache helicopter and night vision camera modules for the F35 Joint Strike Fighter program.

Intevac's trademarks, include the following: 200 Lean[®], AccuLuber[®], EBAPSNERGi[®], I-Port[®], INTEVAC MATRIX[®], MicroVista[®], NightVista[®], Night Port[®], oDLC[®] and INTEVAC VERTEX[®].

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

	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period (In thousands)	July 2, 2016	July 4, 2015	Change over prior period
Thin-film Equipment	\$ 6,088	\$ 11,494	\$ (5,406)	\$ 11,668	\$ 22,122	\$ (10,454)
Photonics:						
Products	6,995	7,152	(157)	14,696	14,606	90
Contract R&D	1,835	1,812	23	2,218	3,615	(1,397)
	8,830	8,964	(134)	16,914	18,221	(1,307)
Total net revenues	\$ 14,918	\$ 20,458	\$ (5,540)	\$ 28,582	\$ 40,343	\$ (11,761)

Thin-film Equipment revenue for the three and six months ended July 2, 2016 decreased from the same periods in the prior year as a result of lower sales of technology upgrades and service, offset in part by higher sales of spare parts. Thin-film Equipment revenue for the three months ended July 4, 2015 included revenue recognized under a NRE arrangement. Thin-film Equipment revenue for both the six months ended July 2, 2016 and July 4, 2015 included revenue recognized one VERTEX coating system for DCPs. Thin-film Equipment revenue for the six months ended July 4, 2015 included revenue recognized for one 200 Lean system.

Photonics revenue for the three month period ended July 2, 2016 decreased slightly from the same period in the prior year as a result of lower product sales revenues. Photonics revenue for the six month period ended July 2, 2016 decreased from the same period in the prior year as a result of lower contract R&D work.

Backlog

	July 2, 2016	January 2, 2016	July 4, 2015
	(In thousands)		
Thin-film Equipment	\$ 49,025	\$ 19,337	\$ 14,002
Photonics	26,262	31,833	29,507
Total backlog	\$ 75,287	\$ 51,170	\$ 43,509

Thin-film Equipment backlog at July 2, 2016 included four 200 Lean disk sputtering systems, one PV deposition system, three PVD coating systems for DCPs and four PV implant systems. Thin-film Equipment backlog at January 2, 2016 includes one PV deposition system, one PVD coating system for DCPs and two PV implant systems. Thin-film Equipment backlog at July 4, 2015 included one PV deposition system and one PV implant system.

Revenue by geographic region

	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
	(In thousands)					
United States	\$ 10,394	\$ 10,976	\$ (582)	\$ 18,537	\$ 27,590	\$ (9,053)
Asia	4,194	8,745	(4,551)	9,489	11,133	(1,644)
Europe	330	737	(407)	556	1,620	(1,064)
Total net revenues	\$ 14,918	\$ 20,458	\$ (5,540)	\$ 28,582	\$ 40,343	\$ (11,761)

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International sales include products shipped to overseas operations of U.S. companies. U.S. sales in 2015 included the delivery of a 200 Lean system to a U.S. factory of a U.S. customer. U.S. sales in 2015 also included revenue recognized under a NRE arrangement with a U.S. PV customer. The decrease in sales to the Asia region in 2016 versus 2015 was primarily due to lower sales of technology upgrades to disk manufacturers. Sales in the Asia region in both 2016 and 2015 included the sale of a VERTEX coating system for DCPs. The decrease in sales to the Europe region in 2016 versus 2015 was primarily due to lower sales of Photonics products to a NATO customer.

Gross profit

	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
	(In thousands, except percentages)					
Thin-film Equipment gross profit	\$ 2,205	\$ 4,714	\$ (2,509)	\$ 2,709	\$ 7,740	\$ (5,031)
% of Thin-film Equipment net revenues	36.2%	41.0%		23.2%	35.0%	
Photonics gross profit	\$ 3,922	\$ 3,092	\$ 830	\$ 7,273	\$ 6,987	\$ 286
% of Photonics net revenues	44.4%	34.5%		43.0%	38.3%	
Total gross profit	\$ 6,127	\$ 7,806	\$ (1,679)	\$ 9,982	\$ 14,727	\$ (4,745)
% of net revenues	41.1%	38.2%		34.9%	36.5%	

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.

Thin-film Equipment gross margin was 36.2% in the three months ended July 2, 2016 compared to 41.0% in the three months ended July 4, 2015 and was 23.2% in the six months ended July 2, 2016 compared to 35.0% in the six months ended July 4, 2015. The decline in gross margin for the three and six months ended July 2, 2016 was due primarily to lower upgrades shipments and lower factory utilization. Gross margins in the Thin-film Equipment business will vary depending on a number of factors, including product mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

Photonics gross margin was 44.4% in the three months ended July 24, 2016 compared to 34.5% in the three months ended July 4, 2015 and was 43.0% in the six months ended July 2, 2016 compared to 38.3% in the six months ended July 4, 2015. The higher gross margin for the three months ended July 2, 2016 was due to higher margins on products due to improved sensor yields and lower inventory provisions. The higher gross margin for the six months ended July 2, 2016 was due to higher margins on products due to improved sensor yields and lower inventory provisions, offset in part by lower margins on contract R&D. Gross margins in the Photonics business will vary depending on a number of factors, including sensor yield, product mix, product cost, pricing, factory utilization, provisions for warranty and inventory reserves.

*Research and development***Three months ended****Six months ended**

	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
	(In thousands)					
Research and development expense	\$ 4,977	\$ 2,947	\$ 2,030	\$ 10,154	\$ 7,555	\$ 2,599

Research and development spending increased in Thin-film Equipment and in Photonics during the three and six month periods ended July 2, 2016 as compared to the same periods in the prior year. Lower Thin-film Equipment

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research and development spending in the second quarter of fiscal 2015 reflected costs recovered under a Non-Recurring Engineering (NRE) arrangement. The increase in Photonics research and development spending was due primarily to increased spending on a demonstrator monocular which we are developing for evaluation by the U.S. Army. Research and development expenses do not include costs of \$1.3 million and \$2.1 million for the three and six months ended July 2, 2016 respectively, or \$1.2 million and \$2.5 million for the three and six months ended July 4, 2015 respectively, which are related to customer-funded contract R&D programs at Photonics and therefore included in cost of net revenues.

Selling, general and administrative

	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
	(In thousands)					
Selling, general and administrative expense	\$ 4,957	\$ 4,576	\$ 381	\$ 9,952	\$ 9,829	\$ 123

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs. Selling, general and administrative expenses for the three and six months ended July 2, 2016 increased compared to the same periods in the prior year due primarily to costs associated with consolidation of our Photonics manufacturing facilities and increased equity compensation expense.

Cost reduction plan

During the first quarter of fiscal 2015, Intevac substantially completed implementation of the 2015 cost reduction plan (the Plan), which reduced expenses and reduced its workforce by 3 percent. The total cost of implementing the Plan was \$148,000 of which \$81,000 was reported under cost of net revenues and \$67,000 was reported under operating expenses. Substantially all cash outlays in connection with the Plan occurred in the first quarter of fiscal 2015. Implementation of the Plan reduced salary, wages and other employee-related expenses by approximately \$1.4 million on an annual basis.

Interest income and other income (expense), net

	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
	(In thousands)					
Interest income and other, income (expense), net	\$ 87	\$ (13)	\$ 100	\$ 125	\$ 66	\$ 59

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

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	Three months ended			Six months ended		
	July 2, 2016	July 4, 2015	Change over prior period	July 2, 2016	July 4, 2015	Change over prior period
Provision for (benefit from) income taxes	\$ (230)	\$ 258	\$ (488)	\$ (204)	\$ 290	\$ (494)

(In thousands)

Intevac recorded income tax benefits of \$230,000 and \$204,000 for the three and six months ended July 2, 2016, and tax provisions of \$258,000 and \$290,000 for the three and six months ended July 4, 2015, respectively. Intevac recorded the following discrete items for audit considerations in foreign jurisdictions: a \$281,000 income tax benefit during the three months ended July 2, 2016 and a \$262,000 income tax charge during the three months ended July 4, 2015. The income tax provisions (benefits) for the three and six month periods are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates. Intevac did not recognize benefits on the U.S. net operating loss and on the Singapore net operating loss for the three and six month periods ended July 2, 2016 and July 4, 2015 due to having full valuation allowances on the U.S. deferred tax assets and on the Singapore deferred tax assets.

Intevac's tax rate differs from the applicable statutory rates due primarily to establishment of a valuation allowance, the utilization of deferred and current credits and the effect of permanent differences and adjustments of prior permanent differences. Intevac's future effective income tax rate depends on various factors, including the level of Intevac's projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carryforwards, availability of tax credits and the effectiveness of Intevac's tax planning strategies. Management carefully monitors these factors and timely adjusts the effective income tax rate.

Liquidity and Capital Resources

At July 2, 2016, Intevac had \$40.6 million in cash, cash equivalents, and investments compared to \$46.6 million at January 2, 2016. During the first six months of 2016, cash, cash equivalents and investments decreased by \$6.0 million due primarily to cash used by operating activities and purchases of fixed assets partially offset by cash received from the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans.

Cash, cash equivalents and investments consist of the following:

	July 2, 2016	January 2, 2016
	(In thousands)	
Cash and cash equivalents	\$ 18,733	\$ 13,746
Short-term investments	16,655	23,208
Long-term investments	5,226	9,673
Total cash, cash equivalents and investments	\$ 40,614	\$ 46,627

Operating activities used cash of \$4.3 million during the first six months of 2016 and generated cash of \$265,000 during the first six months of 2015. The increase in cash used by operating activities was due primarily to a larger net loss, offset in part by decreases in working capital during the first three months of 2016.

Accounts receivable totaled \$16.8 million at July 2, 2016 compared to \$12.3 million at January 2, 2016 as a result of billings for customer advances. Net inventories totaled \$22.5 million at July 2, 2016 compared to \$18.8 million at January 2, 2016. The increase was due primarily to the build out in work in process for shipments with expected deliveries in the second half of 2016. Accounts payable totaled \$4.0 million at July 2, 2016 compared to \$6.0 million at January 2, 2016. Accrued payroll and related liabilities increased to \$4.3 million at July 2, 2016

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compared to \$4.1 million at January 2, 2016. Other accrued liabilities decreased to \$3.6 million at July 2, 2016 compared to \$5.6 million at January 2, 2016 due primarily to the recognition of previously deferred revenue. Customer advances increased to \$15.0 million at July 2, 2016 compared to \$3.6 million at January 2, 2016 due primarily to the receipt of new orders.

Investing activities generated cash of \$9.0 million during the first six months of 2016. Proceeds from sales of investments net of purchases totaled \$11.0 million. Capital expenditures for the six months ended July 2, 2016 were \$2.0 million.

Financing activities in the first six months of 2016 generated cash of \$715,000 through the sale of Intevac common stock to Intevac's employees through Intevac's employee benefit plans offset in part by \$401,000 of tax payments related to the net share settlement.

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

As of July 2, 2016, approximately \$11.3 million of cash and cash equivalents and \$780,000 of restricted cash were domiciled in foreign tax jurisdictions. Intevac expects a significant portion of these funds to remain off shore in the short term. If the Company chose to repatriate these funds to the United States, it would be required to accrue and pay additional taxes on any portion of the repatriation where no United States income tax had been previously provided.

Intevac believes that its existing cash, cash equivalents and investments will be sufficient to meet its cash requirements for the foreseeable future. Intevac intends to undertake approximately \$3.0 million to \$4.0 million in capital expenditures during the remainder of 2016.

Off-Balance Sheet Arrangements

Off-balance sheet firm commitments relating to outstanding letters of credit amounted to approximately \$1.8 million as of July 2, 2016. These letters of credit and bank guarantees are collateralized by \$1.8 million of restricted cash. We do not maintain any other off-balance sheet arrangements, transactions, obligations, or other relationships that would be expected to have a material current or future effect on the consolidated financial statements.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America (US GAAP) requires management to make judgments, assumptions and estimates that affect the amounts reported. Intevac's significant accounting policies are described in Note 1 to the consolidated financial statements included in Item 8 of Intevac's Annual Report on Form 10-K filed on February 17, 2016. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

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

likely to occur, would have a material effect on Intevac's financial condition or results of operations.

Estimates and assumptions about future events and their effects cannot be determined with certainty. Intevac bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is

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obtained and as Intevac's operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they become known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. Many of these uncertainties are discussed in the section below entitled "Risk Factors." Based on a critical assessment of Intevac's accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that Intevac's consolidated financial statements are fairly stated in accordance with US GAAP, and provide a meaningful presentation of Intevac's financial condition and results of operation.

For further information about Intevac's other critical accounting policies, see the discussion of critical accounting policies in Intevac's 2015 Form 10-K. Management believes that there has been no significant change during the six months ended July 2, 2016 to the items identified as critical accounting policies in Intevac's 2015 Form 10-K.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Interest rate risk. Intevac's exposure to market risk for changes in interest rates relates primarily to its investment portfolio. Intevac does not use derivative financial instruments in Intevac's investment portfolio. The Company has adopted an investment policy and established guidelines relating to credit quality, diversification and maturities of its investments in order to preserve principal and maintain liquidity. All investment securities in Intevac's portfolio have an investment grade credit rating. Investments typically consist of commercial paper, obligations of the U.S. government and its agencies, corporate debt securities and municipal bonds.

The table below presents principal amounts and related weighted-average interest rates by year of expected maturity for Intevac's investment portfolio at July 2, 2016.

	2016	2017	2018	Total	Fair Value
	(In thousands, except percentages)				
Cash equivalents					
Variable rate amounts	\$ 9,291			\$ 9,291	\$ 9,291
Weighted-average rate	0.55%				
Short-term investments					
Fixed rate amounts	\$ 4,889	\$ 11,761		\$ 16,650	\$ 16,655
Weighted-average rate	2.13%	1.56%			
Long-term investments					
Fixed rate amounts		\$ 3,206	\$ 2,008	\$ 5,214	\$ 5,226
Weighted-average rate		1.36%	1.48%		
Total investment portfolio	\$ 14,180	\$ 14,967	\$ 2,008	\$ 31,155	\$ 31,172

Foreign exchange risk. From time to time, Intevac enters into foreign currency forward exchange contracts to hedge certain of its anticipated foreign currency re-measurement exposures and to offset certain operational exposures from the impact of changes in foreign currency exchange rates. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on Intevac's operating results. The derivatives have original maturities of approximately 30 days. The notional amount of Company's foreign currency derivatives was \$910,000 at July 2, 2016 and \$924,000 at January 2, 2016.

Item 4. *Controls and Procedures*

Evaluation of disclosure controls and procedures

Intevac maintains a set of disclosure controls and procedures that are designed to ensure that information relating to Intevac, Inc. required to be disclosed in periodic filings under the Securities Exchange Act of 1934, or Exchange Act, is recorded, processed, summarized and reported in a timely manner under the Exchange Act. In

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connection with the filing of this Form 10-Q for the quarter ended July 2, 2016, as required under Rule 13a-15(b) of the Exchange Act, an evaluation was carried out under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of Intevac's disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, Intevac's Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of July 2, 2016.

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

Definition of disclosure controls

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

Limitations on the effectiveness of controls

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

Changes in internal controls over financial reporting

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

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

From time to time, Intevac is involved in claims and legal proceedings that arise in the ordinary course of business. Intevac expects that the number and significance of these matters will increase as Intevac's business expands. Any

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claims or proceedings against us, whether meritorious or not, could be time consuming, result in costly litigation, require significant amounts of management time, result in the diversion of significant operational resources, or require us to enter into royalty or licensing agreements which, if required, may not be available on terms favorable to us or at all. Intevac is not presently a party to any lawsuit or proceeding that, in Intevac's opinion, is likely to seriously harm Intevac's business.

Item 1A. Risk Factors

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

The industries we serve are cyclical, volatile and unpredictable.

A significant portion of our revenue is derived from the sale of equipment used to manufacture commodity technology products such as disk drives, PV solar cells and cell phones. This subjects us to business cycles, the timing, length and volatility of which can be difficult to predict. When demand for commodity technology products exceeds production capacity, then demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of commodity technology products exceeds demand, then demand for new capital equipment such as ours tends to be depressed. For example, sales of systems for magnetic disk production were depressed from late 2007 through 2009. The number of new systems delivered increased in 2010 as customers increased their production capacity in response to increased demand for data storage, but decreased in 2011 through 2015 as the hard disk drive industry did not add the same level of capacity that it did in 2010. We cannot predict with any certainty when these cycles will begin or end. We believe that our sales of systems for magnetic disk production will increase modestly in 2016.

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

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

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

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

customers, and until an order is actually submitted by a customer there is no binding commitment to purchase our systems.

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

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Our 200 Lean customers also experience competition from companies that produce alternative storage technologies like flash memory, which offer smaller size, lower power consumption and more rugged designs. These storage technologies are being used increasingly in enterprise applications and smaller form factors such as tablets, smart-phones, ultra-books, and notebook PCs instead of hard disk drives. Tablet computing devices and smart-phones have never contained, nor are they likely in the future to contain, a disk drive. Products using alternative technologies, such as flash memory, optical storage and other storage technologies are becoming increasingly common and could become a significant source of competition to particular applications of the products of our 200 Lean customers, which could adversely affect our results of operations. If alternative technologies, such as flash memory, replace hard disk drives as a significant method of digital storage, then demand for our hard disk manufacturing products would decrease.

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

We operate in an intensely competitive marketplace, and our competitors have greater resources than we do.

In the market for our disk sputtering systems, we experience competition primarily from Canon Anelva, which has sold a substantial number of systems worldwide. In the Photovoltaic (PV) equipment market, Intevac faces competition from large established competitors including Applied Materials, Centrotherm Photovoltaics, Amtech, Jusun and Von Ardenne. In the market for our military imaging products we experience competition from companies such as Harris Corporation and L-3 Communications. Some of our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do, especially in the PV equipment market. Our competitors may develop enhancements to, or future generations of, competitive products that offer superior price or performance features, and new competitors may enter our markets and develop such enhanced products. Moreover, competition for our customers is intense, and our competitors have historically offered substantial pricing concessions and incentives to attract our customers or retain their existing customers.

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

We have invested heavily, and continue to invest, in the development of new products, such as our 200 Lean and other PVD systems, our solar systems for PV applications, our digital night-vision products and our near-eye display products. Our success in developing and selling new products depends upon a variety of factors, including our ability to: predict future customer requirements, make technological advances, achieve a low total cost of ownership for our products, introduce new products on schedule, manufacture products cost-effectively including transitioning production to volume manufacturing; commercialize and attain customer acceptance of our products; and achieve acceptable and reliable performance of our new products in the field. Our new product decisions and development commitments must anticipate continuously evolving industry requirements significantly in advance of sales. In addition, we are attempting to expand into new or related markets, including the PV and cell phone cover glass markets. Our expansion into the PV market is dependent upon the success of our customers' development plans. To date we have not recognized material revenue from such products. Failure to correctly assess the size of the markets, to successfully develop cost effective products to address the markets or to establish effective sales and support of the new products would have a material adverse effect on future revenues and profits. In addition, if we invest in products for which the market does not develop as anticipated, we may incur significant charges related to such investments.

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

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We are exposed to risks associated with a highly concentrated customer base.

Historically, a significant portion of our revenue in any particular period has been attributable to sales of our disk sputtering systems to a limited number of customers. This concentration of customers, when combined with changes in the customers' specific capacity plans and market share shifts can lead to extreme variability in our revenue and financial results from period to period.

The concentration of our customer base may enable our customers to demand pricing and other terms unfavorable to Intevac, and makes us more vulnerable to changes in demand by a given customer. Orders from a relatively limited number of manufacturers have accounted for, and will likely continue to account for, a substantial portion of our revenues. The loss of one of these large customers, or delays in purchasing by them, could have a material and adverse effect on our revenues.

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

Our quarterly revenues and common stock price have fluctuated significantly. We anticipate that our revenues, operating margins and common stock price will continue to fluctuate for a variety of reasons, including: (1) changes in the demand, due to seasonality, cyclicalities and other factors in the markets for computer systems, storage subsystems and consumer electronics containing disks as well as cell phones and PV solar cells our customers produce with our systems; (2) delays or problems in the introduction and acceptance of our new products, or delivery of existing products; (3) timing of orders, acceptance of new systems by our customers or cancellation of those orders; (4) new products, services or technological innovations by our competitors or us; (5) changes in our manufacturing costs and operating expense; (6) changes in general economic, political, stock market and industry conditions; and (7) any failure of our operating results to meet the expectations of investment research analysts or investors.

Any of these, or other factors, could lead to volatility and/or a rapid change in the trading price of our common shares. In the past, securities class action litigation has been instituted against companies following periods of volatility in the market price of their securities. Any such litigation, if instituted against Intevac, could result in substantial costs and diversion of management time and attention.

We may not be able to obtain export licenses from the U.S. government permitting delivery of our products to international customers.

Many of our products, especially Photonics' products, require export licenses from U.S. government agencies under the Export Administration Act, the Trading with the Enemy Act of 1917, the Arms Export Act of 1976 or the International Traffic in Arms Regulations. These regulations limit the potential market for some of our products. We can give no assurance that we will be successful in obtaining all the licenses necessary to export our products. Heightened government scrutiny of export licenses for defense related products has resulted in lengthened review periods for our license applications. Exports to countries that are not considered by the U.S. government to be allies are likely to be prohibited, and even sales to U.S. allies may be limited. Failure to comply with export control laws, including identification and reporting of all exports and re-exports of controlled technology or exports made without correct license approval or improper license use could result in severe penalties and revocation of licenses. Failure to obtain export licenses, delays in obtaining licenses, or revocation of previously issued licenses would prevent us from selling the affected products outside the United States and could negatively impact our results of operations.

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

We sell our Photonics products and services directly to the U.S. government, as well as to prime contractors for various U.S. government programs. The U.S. government is considering significant changes in the level of existing, follow-on or replacement programs. We cannot predict the impact of potential changes in priorities due to military

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transformations and/or the nature of future war-related activities. A shift of government priorities to programs in which we do not participate and/or reductions in funding for or the termination of programs in which we do participate, unless offset by other programs and opportunities, could have a material adverse effect on our financial position, results of operations, or cash flows.

Funding of multi-year government programs is subject to congressional appropriations, and there is no guarantee that the U.S. government will make further appropriations, particularly given the U.S. government's recent focus on spending in other areas and spending reductions. Sales to the U.S. government and its prime contractors may also be affected by changes in procurement policies, budget considerations and political developments in the United States or abroad. For example, if the U.S. government is less focused on defense spending or there is a decrease in hostilities, demand for our products could decrease. The loss of funding for a government program would result in a loss of future revenues attributable to that program. The influence of any of these factors, which are beyond our control, could negatively impact our results of operations.

A significant portion of our U.S. government revenue is derived from fixed-price development and production contracts. Under fixed-price contracts, unexpected increases in the cost to develop or manufacture a product, whether due to inaccurate estimates in the bidding process, unanticipated increases in material costs, reduced production volumes, inefficiencies or other factors, are borne by us. We have experienced cost overruns in the past that have resulted in losses on certain contracts, and may experience additional cost overruns in the future. We are required to recognize the total estimated impact of cost overruns in the period in which they are first identified. Such cost overruns could have a material adverse effect on our results of operations.

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

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

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

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

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

In previous years, the majority of our revenues have come from regions outside the United States. Most of our international sales are to customers in Asia, which includes products shipped to overseas operations of U.S. companies. We currently have manufacturing facilities in California and Singapore and international customer support offices in Singapore, China, and Malaysia. We expect that international sales will continue to account for a significant portion of our total revenue in future years. Certain of our suppliers are also located outside the United States.

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Managing our global operations presents challenges including, but not limited to, those arising from: (1) global trade issues; (2) variations in protection of intellectual property and other legal rights in different countries; (3) concerns of U.S. governmental agencies regarding possible national commercial and/or security issues posed by growing manufacturing business in Asia; (4) fluctuation of interest rates, raw material costs, labor and operating costs, and exchange rates; (5) variations in the ability to develop relationships with suppliers and other local businesses; (6) changes in the laws and regulations of the United States, including export restrictions, and other countries, as well as their interpretation and application; (7) the need to provide technical and spares support in different locations; (8) political and economic instability; (9) cultural differences; (10) varying government incentives to promote development; (11) shipping costs and delays; (12) adverse conditions in credit markets; (13) variations in tariffs, quotas, tax codes and other market barriers; and (14) barriers to movement of cash.

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

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

As a result of our acquisitions, we have significant intangible assets and had significant goodwill on our balance sheet. We test these assets for impairment on a periodic basis as required, and whenever events or changes in circumstances indicate that the carrying value may not be recoverable. The events or changes that could require us to test our intangible assets for impairment include: a significant reduction in our stock price, and as a result market capitalization, changes in our estimated future cash flows, as well as changes in rates of growth in our industry or in any of our reporting units. In the fourth quarter of 2012, as a result of a decline in our market capitalization and a reduction in our revenue expectations we recorded a goodwill impairment charge in the amount of \$18.4 million. We will continue to evaluate the carrying value of our intangible assets and if we determine in the future that there is a potential further impairment, we may be required to record additional charges to earnings which could materially adversely affect our financial results and could also materially adversely affect our business.

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 do not maintain key person life insurance on any of our employees. The expansion of high technology companies worldwide has increased demand and competition for qualified personnel, and has made companies increasingly protective of prior employees. It may be difficult for us to locate employees who are not subject to non-competition agreements and other restrictions.

The majority of our U.S. operations are located in California where the cost of living and of recruiting employees is high. Our operating results depend, in large part, upon our ability to retain and attract qualified management, engineering, marketing, manufacturing, customer support, sales and administrative personnel. Furthermore, we compete with industries such as the hard disk drive, semiconductor, and solar industries for skilled employees. Failure to retain existing key personnel, or to attract, assimilate or retain additional highly qualified employees to meet our needs in the future, could have a material and adverse effect on our business, financial condition and results of operations.

We are dependent on certain suppliers for parts used in our products.

We are a manufacturing business. Purchased parts constitute the largest component of our product cost. Our ability to manufacture depends on the timely delivery of parts, components and subassemblies from suppliers. We obtain some of the key components and subassemblies used in our products from a single supplier or a limited group of suppliers.

If any of our suppliers fail to deliver quality parts on a timely basis, we may experience delays in manufacturing, which could result in delayed product deliveries, increased costs to expedite deliveries or develop alternative suppliers, or require redesign of our products to accommodate alternative suppliers. Some of our suppliers are thinly capitalized and may be vulnerable to failure.

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

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

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

We could be involved in litigation.

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

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

We have completed a number of acquisitions and dispositions during our operating history. For example, in 2007, we acquired certain assets of DeltaNu, LLC and certain assets of Creative Display Systems, LLC, in 2008 we acquired certain assets of OC Oerlikon Balzers Ltd., in 2010 we acquired the outstanding shares of SIT, in 2012 we completed the sale of certain semiconductor mainframe technology assets and in 2013 we completed the sale of the assets of DeltaNu. We have spent and may continue to spend significant resources identifying and pursuing future acquisition opportunities. Acquisitions involve numerous risks including: (1) difficulties in integrating the operations, technologies and products of the acquired companies; (2) the diversion of our management's attention from other business concerns; and (3) the potential loss of key employees of the acquired companies. Failure to achieve the anticipated benefits of the prior and any future acquisitions or to successfully integrate the operations of the companies we acquire could have a material and adverse effect on our business, financial condition and results of operations. Any future acquisitions could also result in potentially dilutive issuance of equity securities, acquisition or divestiture-related write-offs or the assumption of debt and contingent liabilities. In addition, we have made and will continue to consider making strategic divestitures. With any divestiture, there are risks that future operating results could be unfavorably impacted if targeted objectives, such as cost savings, are not achieved or if other business disruptions occur as a result of the divestiture or activities related to the divestiture.

We are subject to risks of non-compliance with environmental and other governmental regulations.

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

our officers, directors or employees. Additionally, these regulations could require us to acquire expensive remediation or abatement equipment or to incur substantial expenses to comply with them.

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

Table of Contents***Business interruptions could adversely affect our operations.***

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

We could be negatively affected as a result of a proxy contest and the actions of activist stockholders.

A proxy contest with respect to election of our directors, or other activist stockholder activities, could adversely affect our business because: (i) responding to a proxy contest and other actions by activist stockholders can be costly and time-consuming, disruptive to our operations and divert the attention of management and our employees; (ii) perceived uncertainties as to our future direction caused by activist activities may result in the loss of potential business opportunities, and may make it more difficult to attract and retain qualified personnel and business partners; and (iii) if individuals are elected to our Board of Directors with a specific agenda, it may adversely affect our ability to effectively and timely implement our strategic plans.

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

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

We have completed the evaluation of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Although our assessment, testing, and evaluation resulted in our conclusion that as of January 2, 2016, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. Ongoing compliance with this requirement is complex, costly and time-consuming. If Intevac fails to maintain effective internal control over financial reporting; our management does not timely assess the adequacy of such internal control; or our independent registered public accounting firm does not deliver an unqualified opinion as to the effectiveness of our internal control over financial reporting, then we could be subject to restatement of previously reported financial results, regulatory sanctions and a decline in the public's perception of Intevac, which could have a material and adverse effect on our business, financial condition and results of operations.

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

The following table provides information as of July 2, 2016 with respect to the shares of common stock repurchased by Intevac during the second quarter of fiscal 2016.

	Total Number of Shares Purchased as Part of Publicly Announced Program*	Maximum Dollar Value of Shares That May Yet be Purchased Under the Program*
	Total Number of Shares Purchased	Average Price Paid per Share
	Aggregate Price Paid	
	(in thousands, except per share data)	
July 3, 2016 to July 30, 2016		\$ 1,507
May 1, 2016 to May 28, 2016		\$ 1,507
May 29, 2016 to July 2, 2016		\$ 1,507

* On November 21, 2013, the Board of Directors approved a stock repurchase program authorizing up to \$30.0 million in repurchases.

Item 3. Defaults upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

The following exhibits are filed herewith:

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

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SIGNATURES

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

INTEVAC, INC.

Date: August 2, 2016

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

Date: August 2, 2016

By: /s/ JAMES MONIZ
James Moniz

Executive Vice President, Finance and
Administration,
Chief Financial Officer, Treasurer and Secretary
(Principal Financial and Accounting Officer)