INTEVAC INC
Form 10-K
February 22, 2013

# UNITED STATES SECURITIES AND EXCHANGE COMMISSION

**Washington, D.C. 20549**

# Form 10-K

(Mark One)

þ **ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d)**
**OF THE SECURITIES EXCHANGE ACT OF 1934**
**For the fiscal year ended December 31, 2012**

**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** | **94-3125814** |
|---|---|
| *(State or other jurisdiction of incorporation or organization)* | *(I.R.S. 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**

**Securities registered pursuant to Section 12(b) of the Act:**

| **Title of each class** | **Name of each exchange on which registered** |
|---|---|
| Common Stock ($0.001 par value) | The Nasdaq Stock Market LLC (NASDAQ Global Select) |

**Securities registered pursuant to Section 12(g) of the Act:**

**None.**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. ¨ Yes þ No

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. ¨ Yes þ No

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. þ 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). þ Yes ¨ No

Indicate by a check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K(§ 229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. þ

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

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

As of June 30, 2012, the aggregate market value of voting and non-voting stock held by non-affiliates of the Registrant, was approximately $85,321,183 (based on the closing price for shares of the Registrant s Common Stock as reported by the Nasdaq Stock Market for the last trading day prior to that date). Shares of Common Stock held by each executive officer, director, and holder of 5% or more of the outstanding Common Stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

On February 22, 2013, 23,769,658 shares of the Registrant s Common Stock, $0.001 par value, were outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE.**

Portions of the Registrant s Proxy Statement for the 2013 Annual Meeting of Stockholders are incorporated by reference into Part III. Such proxy statement will be filed within 120 days after the end of the fiscal year covered by this Annual Report on Form 10-K.

**CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS**

Certain information in this Annual Report on Form 10-K (report or Form 10-K) of Intevac, Inc. and its subsidiaries ( Intevac or the Company ), including Management s Discussion and Analysis of Financial Condition and Results of Operations in Item 7, is forward-looking in nature. All statements in this report, including those made by the management of Intevac, other than statements of historical fact, are forward-looking statements. Examples of forward-looking statements include statements regarding Intevac s future financial results, operating results, cash flows and cash deployment strategies, business strategies, costs, products, working capital, competitive positions, management s plans and objectives for future operations, research and development, acquisitions and joint ventures, growth opportunities, customer contracts, investments, liquidity, declaration of dividends, and legal proceedings, as well as market conditions and industry trends. These forward-looking statements are based on management s estimates, projections and assumptions as of the date hereof and include the assumptions that underlie such statements. Forward-looking statements may contain words such as may, will, should, could, would, expect, plan, anticipate, belie predict, potential and continue, the negative of these terms, or other comparable terminology. Any expectations based on these forward-looking statements are subject to risks and uncertainties and other important factors, including those discussed in Item 1A, Risk Factors, below and elsewhere in this report. Other risks and uncertainties may be disclosed in Intevac s prior Securities and Exchange Commission ( SEC ) filings. These and many other factors could affect Intevac s future financial condition and operating results and could cause actual results to differ materially from expectations based on forward-looking statements made in this report or elsewhere by Intevac or on its behalf. Intevac undertakes no obligation to revise or update any forward-looking statements.

The following information should be read in conjunction with the Consolidated Financial Statements and the accompanying Notes to Consolidated Financial Statements included in this report.

**PART I**

**Item 1.** ***Business***

**Overview**

Intevac s business consists of two reportable segments:

**Equipment:** Intevac is a leader in the design, development and marketing of high-productivity process manufacturing equipment solutions to the hard disk drive industry. Intevac also offers high-productivity process manufacturing equipment for the solar photovoltaic ( PV ) industry.

**Intevac Photonics:** Intevac is a leader in the development and manufacture of leading edge, high-sensitivity imaging products and vision systems, as well as Raman spectroscopy instruments. Markets addressed include military, medical, scientific, pharmaceutical and other industrial markets.

Intevac was incorporated in California in October 1990 and was reincorporated in Delaware in 2007.

**Equipment Segment**

***Hard Disk Drive Equipment Market***

Intevac designs, manufactures, markets and services complex capital equipment used to deposit thin films and lubricants onto substrates to produce magnetic disks that are used in hard disk drives. Disk and disk drive manufacturers produce magnetic disks in a sophisticated manufacturing process involving many steps, including plating, annealing, polishing, texturing, sputtering, etching, stripping and lubrication. Intevac believes its systems represent approximately 60% of the installed capacity of disk sputtering systems worldwide. Intevac s systems are used by manufacturers of magnetic media such as Seagate Technology, Western Digital, including its wholly-owned subsidiary, HGST, Fuji Electric, and Showa Denko.

Hard disk drives are a primary storage medium for digital data including on-line, cloud storage, and near-line applications and are used in products and applications such as personal computers, enterprise data storage, and video players and video game platforms. Intevac believes that hard disk drive media shipments will continue to grow over time, driven by growth in digital storage, by the slowing of areal density improvements, by the refresh of personal computers for new operating and application software, by the proliferation of personal computers into emerging economies, and by new and emerging applications. Continued growth in the amount of digital data stored and the slowing in areal density improvements are key factors in determining the demand for magnetic disks used in hard disk drives.

Intevac expects that hard disk drive manufacturers will extend their utilization of planar perpendicular media with the introduction of thermal assisted magnetic recording ( TAMR ) expected within the next three to four years. Intevac believes that the transition to TAMR will require disk manufacturers to upgrade their installed base of equipment, which would result in increased demand for equipment technology upgrades to be performed by Intevac. The introduction of patterned media is expected to occur several years after the transition to TAMR. Intevac believes that the transition to patterned media by disk manufacturers, which introduces new processes and requires new equipment, is expected to result in increased demand for Intevac s equipment. Intevac introduced the 200 Lean Gen II etch and deposition system in 2009 which is being used by the industry for patterned media application development.

***Hard Disk Drive Equipment Products***

*Disk Sputtering Systems*

Disk sputtering is the process of depositing a thin film of various materials on a substrate. Intevac equipment deposits magnetic films, non-magnetic films and protective carbon-based overcoats on disks that are to be used in hard disk drives using sputtering or chemical vapor deposition ( CVD ) technologies.

Intevac s 200 Lean systems began shipping in 2003, and the first 200 Lean Gen II systems shipped in 2008, with the installed base of 200 Lean systems reaching 155 systems by the end of 2012. Intevac estimates that approximately 90% of the installed base is used in production with the balance used for research and development.

In 2009, Intevac shipped the first 200 Lean Gen II etch and deposition system to be used for patterned media. Intevac provides a cost-effective solution for high-volume manufacturing by providing new etch and associated process modules on the high-productivity 200 Lean Gen II platform.

*Disk Lubrication Systems*

Disk lubrication is the manufacturing step that follows deposition of thin films. During lubrication, a microscopic layer of lubricant is applied to the disk s surface to improve durability and reduce surface friction between the disk and the read/write head assembly.

The Intevac AccuLuber™ lubricates disks by depositing a thin film of lubricant on the disk while it is under vacuum, thus eliminating the use of solvents, which are environmentally hazardous and expensive to procure, store and dispose.

*Non-Systems Business*

Intevac also provides technology upgrades, spare parts and consumables, installation, maintenance and repair services to Intevac s system customers. Intevac continues to develop and market new upgrades to its installed base that support the continued growth in areal density or improve the manufacturing cost per disk. Non-system business as a percentage of Equipment revenues was 27% in 2010, 66% in 2011 and 78% in 2012.

***Solar Market***

Intevac designs, manufactures and markets capital equipment for the PV solar manufacturing industry.

The cost of electricity generated from solar energy, in most cases, remains higher than that of electricity generated from traditional energy sources. However in some markets, the cost of generating solar electricity is

now on parity with that of traditional energy sources. In those countries or areas where the cost of solar energy generation remains higher than traditional electricity, some governments have implemented various tax credits and other financial incentives to promote the growth in alternative energy sources. As the cost of solar energy has declined many of these governments have reduced their incentives and this trend is expected to continue.

Energy generated from solar amounts to less than 1% of electricity generated in the world today. The market for solar energy is expected to grow from 30 gigawatts in 2012 to 44 gigawatts in 2015. Today the manufacturing capacity for the production of solar cells and modules, estimated at 40 gigawatts, far exceeds the demand.

Over the next few years solar is now being forecasted to approach the cost of traditional energy sources for some applications. Demand for solar energy is forecasted to grow at approximately a 20% compound annual growth rate through 2016.

The continued focus in the PV market is on the development of high-efficiency cell technologies aimed at simultaneously boosting efficiency and reducing production costs. New vacuum process technologies and integrated processing steps are expected to become increasingly important as companies search for lower cost manufacturing solutions.

A solar cell (also called a PV cell) is a solid state device that converts the energy of sunlight directly into electricity. Assemblies of cells are used to make solar modules, also known as solar panels. Solar panels have broad-based end market applications for solar farms, integrated building PV arrays, rooftop grids and portable devices.

Intevac offers products for wafer-based crystalline silicon ( c-Si ) solar cell manufacturing processes. More than 90% of solar cells produced are made using c-Si wafers.

***Solar Manufacturing Products***

*Solar Cell Processing System*

Intevac offers vacuum process manufacturing solutions for c-Si applications. Intevac s platform, LEAN SOLAR is a high-productivity process equipment solution enabling low-cost solar cell manufacturing and high cell efficiency.

Intevac has developed three vacuum process application technologies for the LEAN SOLAR platform: for doping by ion implant, for etching or texturing the surface of a solar cell, and for deposition of thin films such as transparent conductive oxides. Intevac s products include LEAN SOLAR ENERGi ion implant, NanoTexture , and integrated physical vapor deposition ( PVD ). Intevac s ENERGi ion implantation system is based upon technology developed by Solar Implant Technologies, Inc. ( SIT ) which was acquired by Intevac in November 2010. These systems are designed to run at high throughput and can be integrated into new or existing solar processing lines.

*LEAN SOLAR ENERGi*

Ion implantation is a technique being introduced to solar cell lines as a means to increase overall cell efficiency. Ion implantation can replace existing diffusion processes and is also extendable to new advanced cell structures with fewer processing steps and therefore at lower cost. The ion implant process developed with Intevac s LEAN SOLAR ENERGi product enables precision engineering of the dopant elements such as Phosphorous and Boron to form the emitter in the solar cell.

*LEAN SOLAR NanoTexture*

Texturing is a method used in solar cell processing as a means of lowering surface reflectance and therefore capturing more light or photons resulting in higher overall solar cell efficiencies. Today, texturing is typically carried out using wet chemicals such as acids that produce a rough textured surface on the solar cell. The LEAN SOLAR NanoTexture is a dry etch processing system that enables lower reflectance and therefore higher cell efficiency.

*LEAN SOLAR PVD*

PVD is a process used in multiple steps in the manufacturing of solar cells such as for electrical contacts, conductor layers, reflective layers, and transparent conductive oxides all of which are critical to the efficiency of solar cells. The LEAN SOLAR PVD system can deposit all of these layers for a variety of c-Si PVD applications as well as thin film solar layers.

***Semiconductor Equipment Market***

Prior to January 2012, Intevac designed, manufactured and marketed vacuum wafer-handling automation equipment to the semiconductor manufacturing industry. In January 2012, Intevac divested the semiconductor mainframe technology and sold certain assets comprising its semiconductor mainframe technology to Brooks Automation, Inc. ( Brooks. )

**Intevac Photonics Segment**

***Intevac Photonics Market***

Intevac Photonics develops, manufactures and sells compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and materials identification. These products incorporate high resolution digital image sensors operating in the visible and near infrared ( NIR ) light spectrums and are based on Intevac s proprietary EBAPS® (Electron Bombarded Active Pixel Sensor) technology.

Intevac Photonics products primarily address the high performance military night-vision market. Key applications provide digital imagery in extremely low-light level conditions. Intevac provides these products for military aircraft, ground vehicles, and soldier head-mounted and weapon-mounted applications. In additional to military night-vision products, Intevac also develops and manufactures Raman spectroscopy systems for the detection and identification of materials in the chemical, biological and explosives threat detection ( CBNRE ), pharmaceutical, plastics and law enforcement industries.

***Military Products***

Intevac s EBAPS sensors are incorporated into custom-designed products for high performance military applications. Intevac s EBAPS sensors can be integrated at various levels with optics, electronics, software, and displays based upon customer specifications and requirements. Customization typically occurs in the areas of electronics, near-eye micro-displays, and mechanical packaging. Product configurations include sensors, cameras, and complete systems. Intevac s products by application are:

*Rifle Sight*

Intevac offers low-light 1.3 mega-pixel EBAPS modules that are integrated by our customers into a weapon sight attached to weaponry including rifles for night time aiming and targeting.

*Helicopter Pilotage*

Intevac offers a night-vision camera with a 2.0 mega-pixel resolution EBAPS module which is gimbal- mounted on the helicopter. The low-light level digital video is then viewable by the helicopter pilot on a head mounted display enabling the pilot to fly at night time and in adverse conditions.

*Fixed Wing Aircraft Pilotage*

Intevac offers night-vision cameras with 1.3 and 2.0 mega-pixel resolutions which are embedded into a fighter pilot s helmet and enables the pilot to fly at night time and in adverse conditions.

*Long-Range Target Identification*

Intevac offers the Laser Illuminated Viewing and Ranging ( LIVAR® ) shortwave-infrared camera for long range military night time surveillance systems that can identify targets at distances of up to twenty kilometers. Intevac Photonics LIVAR camera is incorporated into long range target identification systems manufactured by major defense contractors.

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*Soldier Mobility*

Both the U.S. Army and Special Operations Command are sponsoring programs to develop binocular night vision goggles incorporating digitally fused low-light level and thermal image sensors. Both head-mounted digital imaging systems will allow low-light level and thermal imagery to be viewed individually or to be overlaid.

*Simulation and Training*

Near-eye display systems are high-performance, micro-display products for near-eye, portable viewing of video in military and commercial markets. Intevac s eyeglass and helmet-mounted display systems provide high definition and a wide field-of-view in miniaturized light-weight and portable designs. Intevac s I-Port™ helmet-mounted display provides solutions for such diverse markets as medical, industrial, commercial and military, including training and simulation.

***Commercial Products***

*Raman Materials Identification Instruments*

Products include Raman spectroscopy systems that perform non-destructive identification of solid materials, powders and liquids by illuminating the sample with a laser and measuring the characteristic spectrum of light scattered from the tested sample. Raman spectroscopy can be used in forensics, homeland security, geology, gemology, medical, pharmaceutical and industrial quality assurance applications. Intevac has developed a series of Raman spectroscopy instruments that incorporate Intevac s core NIR sensors to enable the detection and identification of critical materials in the CBNRE, pharmaceutical, plastics and law enforcement industries.

*Low-Light Cameras*

Intevac Photonics MicroVista® product line of commercial compact and lightweight low-light Complementary Metal Oxide Semiconductor ( CMOS ) cameras provides high sensitivity in the ultraviolet, visible or NIR regions of the spectrum for use in industrial inspection, bio-medical and scientific applications. These cameras are primarily sold through distribution channels and to original equipment manufacturers.

**Backlog**

Intevac s backlog of orders at December 31, 2012 was $35.2 million, as compared to $32.9 million at December 31, 2011. Backlog at December 31, 2012 consisted of $8.9 million of Equipment backlog and $26.3 million of Intevac Photonics backlog. Backlog at December 31, 2011 consisted of $17.9 million of Equipment backlog and $15.0 million of Intevac Photonics backlog. The decrease in Equipment backlog was primarily the result of decreased orders for 200 Lean disk sputtering systems, upgrades and LEAN SOLAR systems. Backlog at December 31, 2012 does not include any 200 Lean systems or LEAN SOLAR systems, as compared to one LEAN SOLAR system in backlog at December 31, 2011. Backlog includes only customer orders with scheduled delivery dates.

**Customer Concentration**

Historically, a significant portion of Intevac s revenue in any particular period has been attributable to sales to a limited number of customers.

The following customers accounted for at least 10 percent of Intevac s consolidated net revenues in 2012, 2011, and/or 2010.

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Seagate Technology | 51% | 41% | 40% |
| U.S. Government | 10% | * | * |
| HGST | * | 12% | 26% |
| Fuji Electric | * | * | 12% |

* Less than 10%

Intevac expects that sales of Intevac s products to relatively few customers will continue to account for a high percentage of Intevac s revenues in the foreseeable future.

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Foreign sales accounted for 63% of revenue in 2012, 65% of revenue in 2011, and 77% of revenue in 2010. The majority of Intevac s foreign sales are to companies in Asia or to U.S. companies for use in their Asian manufacturing or development operations. Intevac anticipates that foreign sales will continue to be a significant portion of Intevac s Equipment revenues. Intevac s disk sputtering equipment customers include magnetic disk manufacturers, such as Fuji Electric and Showa Denko, and vertically integrated hard disk drive manufacturers, such as Seagate, Western Digital and HGST. Intevac s customers manufacturing facilities are primarily located in California, China, Taiwan, Japan, Malaysia and Singapore.

**Competition**

The principal competitive factors affecting the markets for Intevac Equipment products include price, product performance and functionality, ease of integration, customer support and service, reputation and reliability. Intevac has one major competitor, Canon Anelva, in the hard disk drive equipment market and has historically experienced intense worldwide competition for magnetic disk sputtering equipment. Intevac primarily faces competition from large established global competitors in the PV equipment market including Applied Materials, Centrotherm Photovoltaics, Amtech, Jusung and Von Ardenne. These competitors may have substantially greater financial, technical, marketing, manufacturing and other resources as compared to Intevac. Furthermore, any of Intevac s competitors may develop enhancements to, or future generations of, competitive products that offer superior price or performance features. In addition, new competitors, with enhanced products may enter the markets that Intevac currently serves.

The principal competitive factors affecting Intevac Photonics products include price, extreme low-light level detection performance, power consumption, resolution, size, ease of integration, reliability, reputation and customer support and service. Intevac faces substantial competition for Intevac Photonics products, and many competitors have substantially greater resources and brand recognition. In the military market, ITT Exelis and L-3 Communications are large and well-established defense contractors and are the primary U.S. manufacturers of analog image intensifier tubes used in Generation-III night vision devices and their derivative products. Intevac expects that other companies will develop digital night vision products and aggressively promote their sales. Furthermore, Intevac s LIVAR target identification sensors and cameras face competition from CMC Electronics, DRS, FLIR Systems, Goodrich and Raytheon, established companies that manufacture infrared sensors and cameras which are presently used in long-range target identification systems. Within the near-eye display market, Intevac also faces competition from Rockwell-Collins and Vuzix, both of which can offer cost-competitive products.

**Marketing and Sales**

Equipment sales are made primarily through Intevac s direct sales force. Intevac also sells its products through distributors in Japan and China. The selling process for Intevac s Equipment products is multi-level and lengthy, involving individuals from marketing, engineering, operations, customer service and senior management.

Installing and integrating new equipment requires a substantial investment by a customer. Sales of Intevac s systems depend, in significant part, upon the decision of a prospective customer to replace obsolete equipment or to increase manufacturing capacity by upgrading or expanding existing manufacturing facilities or by constructing new manufacturing facilities, all of which typically involve a significant capital commitment. After making a decision to select Intevac s equipment, Intevac s customers typically purchase one or more engineering systems to develop and qualify their production process prior to ordering and taking delivery of multiple production systems. Accordingly, Intevac s systems have a lengthy sales cycle, during which Intevac may expend substantial funds and management time and effort with no assurance that a sale will result.

The production of large complex systems requires Intevac to make significant investments in inventory both to fulfill customer orders and to maintain adequate supplies of spare parts to service previously shipped systems. In some cases Intevac manufactures subsystems and/or complete systems prior to receipt of a customer order to smooth Intevac s production flow and/or reduce lead time.

Intevac maintains inventories of spare parts in the United States, Singapore, Malaysia, China and Europe to support its Equipment customers. Intevac often requires its Equipment customers to pay for systems in three installments, with a portion of the system price billed upon receipt of an order, a portion of the price billed upon shipment, and the balance of the price and any sales tax due upon completion of installation and acceptance of the system at the customer s factory.

Intevac provides process and applications support, customer training, installation, start-up assistance and post-installation service support to Intevac s Equipment customers. Intevac has field offices in Singapore, China, and Malaysia to support Intevac s customers in Asia.

Warranties for Intevac s Equipment products typically range between 12 and 24 months from customer acceptance. During the warranty period any necessary non-consumable parts are supplied and installed without charge.

Sales of Intevac Photonics products for military applications are primarily made to the end user through Intevac s direct sales force. Intevac sells to leading defense contractors such as Lockheed Martin Corporation, Northrop Grumman Corporation, Raytheon, DRS Technologies, BAE and Sagem.

Intevac is subject to long sales cycles in the Photonics segment because many of Intevac s products, such as Intevac s night vision systems, typically must be designed into Intevac s customers products, which are often complex and state-of-the-art. These development cycles are generally multi-year, and Intevac s sales are dependent on Intevac s customer successfully integrating Intevac s product into its product, completing development of its product and then obtaining production orders for its product. Sales of these products are also often dependent on ongoing funding of defense programs by the U.S. government and its allies. Additionally, sales to international customers are contingent on issuance of export licenses by the U.S. government.

Sales of Intevac Photonics commercial products are made through a combination of direct sales, distributors and value added resellers and can also be subject to long sales cycles.

Intevac Photonics generally invoices its research and development customers either as costs are incurred, or as program milestones are achieved, depending upon the particular contract terms. As a government contractor, Intevac invoices customers using estimated annual rates approved by the Defense Contracts Audit Agency ( DCAA ).

**Research and Development and Intellectual Property**

Intevac s long-term growth strategy requires continued development of new products. Intevac works closely with Intevac s customers to design products that meet their planned technical and production requirements. Product development and engineering organizations are located primarily in the United States and Singapore.

Intevac invested $31.8 million (38.1% of net revenues) in fiscal 2012, $34.3 million (41.3% of net revenues) in fiscal 2011, and $27.9 million (13.8% of net revenues) in fiscal 2010 for product development and engineering programs to create new products and to improve existing technologies and products. Intevac has spent an average of 28.2% of net revenues on product development and engineering over the last five years.

Intevac s competitive position significantly depends on Intevac s research, development, engineering, manufacturing and marketing capabilities, and not just on Intevac s patent position. However, protection of Intevac s technological assets by obtaining and enforcing intellectual property rights, including patents, is important. Therefore, Intevac s practice is to file patent applications in the United States and other countries for inventions that Intevac considers important. Intevac has more than 250 patents in the United States and other countries, and additional applications are pending for new inventions. Although Intevac does not consider Intevac s business materially dependent upon any one patent, the rights of Intevac and the products made and sold under Intevac s patents along with other intellectual property, including trademarks, know-how, trade secrets and copyrights, taken as a whole, are a significant element of Intevac s business.

Intevac enters into patent and technology licensing agreements with other companies when management determines that it is in Intevac s best interest to do so. Intevac pays royalties under existing patent license agreements for use of certain patented technologies in several of Intevac s products. Intevac also receives, from time to time, royalties from licenses granted to third parties. Royalties received from or paid to third parties have not been material to Intevac s consolidated results of operations.

In the normal course of business, Intevac periodically receives and makes inquiries regarding possible patent infringements. In dealing with such inquiries, it may be necessary or useful for us to obtain or grant licenses or other rights. However, there can be no assurance that such licenses or rights will be available to us on commercially reasonable terms, or at all. If Intevac is not able to resolve or settle claims, obtain necessary licenses and/or successfully prosecute or defend Intevac s position, Intevac s business, financial condition and results of operations could be materially and adversely affected.

**Manufacturing**

Intevac manufactures its Equipment products at its facilities in California and Singapore. Intevac s Equipment manufacturing operations include electromechanical assembly, vacuum processing, fabrication of sputter sources, and system assembly, alignment and testing.

Intevac Photonics products are manufactured at Intevac s facilities in California and Wyoming. Intevac Photonics manufactures sensors, cameras, integrated camera systems, compact Raman spectroscopy instruments and near-eye display systems using advanced manufacturing techniques and equipment. Intevac s operations include vacuum processing, and electromechanical and optical system assembly.

**Employees**

At December 31, 2012, Intevac had 387 employees, including 12 contract employees.

**Compliance with Environmental Regulations**

Intevac is 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. Intevac treats the cost of complying with government regulations and operating a safe workplace as a normal cost of business and allocates the cost of these activities to all functions, except where the cost can be isolated and charged to a specific function. The environmental standards and regulations promulgated by government agencies in California, Wyoming and Singapore are rigorous and set a high standard of compliance. Intevac believes its costs of compliance with these regulations and standards are comparable to other companies operating similar facilities in these jurisdictions.

**Executive Officers of the Registrant**

Certain information about our executive officers as of February 22, 2013 is listed below:

| Name | Age | Position |
|---|---|---|
| *Executive Officers:* | | |
| Norman H. Pond | 74 | Chairman of the Board and Chief Executive Officer |
| Jeffrey Andreson | 51 | Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary |
| Andres Brugal | 55 | Executive Vice President and General Manager, Intevac Photonics |
| Michael Russak | 66 | Executive Vice President and General Manager, Hard Disk Equipment Products |
| Christopher Smith | 53 | Executive Vice President, Emerging Markets |
| *Other Key Officers:* | | |
| Babak Adibi | 58 | Vice President and General Manager, Solar Implant |
| Verle Aebi | 58 | Chief Technology Officer, Intevac Photonics |
| James Birt | 48 | Vice President, Manufacturing and Customer Support, Equipment Products |
| Terry Bluck | 53 | Vice President, Technology, Equipment Products |
| Kimberly Burk | 47 | Vice President, Human Resources |
| Timothy Justyn | 50 | Vice President of Operations, Intevac Photonics |
| William Maffucci | 56 | Vice President of Strategic Development, Intevac Vision Systems |

*Mr. Pond* is a founder of Intevac and has served as Chairman of the Board since February 1991. Mr. Pond has served as Chief Executive Officer from November 2012 until the present. Mr. Pond also served as President and Chief Executive Officer from September 2001 through January 2002 and from February 1991 until July 2000. Mr. Pond also held executive management positions at Varian Associates and Teledyne. Mr. Pond holds a BS in physics from the Missouri Institute of Science and Technology and an MS in physics from the University of California at Los Angeles.

*Mr. Andreson* joined Intevac in June 2007 and has served as Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary since August 2007. Prior to joining Intevac, Mr. Andreson served as Managing Director and Controller of Applied Materials Global Services product group. Since joining Applied Materials in 1995, Mr. Andreson held a number of senior financial positions, including Managing Director, Global Financial Planning and Analysis; Controller, Metron Subsidiary; Controller, North American Sales and Service; and Controller, Volume Manufacturing. From 1989 through 1995, Mr. Andreson held various roles at Measurex Corporation. Mr. Andreson holds an MBA from Santa Clara University and a BS in finance from San Jose State University.

*Mr. Brugal* joined Intevac as Executive Vice President and General Manager, Intevac Photonics in January 2012. Before joining Intevac, Mr. Brugal was employed at Vision Systems International, a joint venture between Rockwell Collins and Elbit Systems of America, from 2006 to 2012, serving as President and Chief Executive Officer from April 2007 to January 2012. From 2005 to 2006, Mr. Brugal was employed as a consultant for DRS Technologies, a subsidiary of Finmeccanica SPA. Mr. Brugal retired from active service with the U.S. Navy in October 2005 with the rank of Captain. Mr. Brugal holds an MS in strategic studies and security affairs from the U.S. Naval War College; and a BS in general engineering from the U.S. Naval Academy.

*Dr. Russak* joined Intevac in July 2008 and currently serves as Executive Vice President and General Manager, Hard Disk Equipment Products. Before joining Intevac Dr. Russak served as President and Chief Technical Officer of Komag from 2000 to 2007. From 1993 to 2000, Dr. Russak served as Vice President of Research and Development at HMT Technology. Previously, Dr. Russak held management positions in the Research Division of IBM Corporation. Prior to IBM, Dr. Russak worked for Grumman Aerospace Corporation as a contributing scientist. Dr. Russak holds a BS in ceramic engineering and a PhD in materials science from Rutgers University.

*Mr. Smith* joined Intevac in August 2010 as Executive Vice President, Emerging Markets. Mr. Smith has over 25 years of executive-level experience in the semiconductor and solar capital equipment markets. Prior to joining Intevac, Mr. Smith served as Senior Vice President Sales and Customer Support at Oerlikon Solar, from November 2007 to August 2010. From 2006 to 2007 he served as Senior Vice President of Sales and Service with Cymer. Previously, Mr. Smith was employed by Applied Materials from 1994 to 2006. While at Applied Materials he held a variety of executive-level customer support and operations positions. He also served as product business group general manager for Chemical Mechanical Polishing and was managing director of Global Business Development for the Dielectric and Physical Vapor Deposition Product Business Groups. Mr. Smith earned his BS in Business Administration / Material Management from San Jose State University.

*Dr. Adibi* joined Intevac in November 2010 as Vice President and General Manager, Solar Implant. Prior to joining Intevac, Dr. Adibi was President, Chief Technology Officer and Co-Founder of Solar Implant Technologies. Prior to founding Solar Implant Technologies, Dr. Adibi worked for Silicon Genesis Corporation from 2006 to 2008 as the General Manager of the Solar Equipment Division. From 2003 to 2006 he served as Vice President in the Laser Annealing Product Division of Ultratech. Previously, Dr. Adibi was employed by Applied Materials from 1985 to 2003. While at Applied Materials he held a variety of executive-level engineering positions. Dr. Adibi holds numerous patents in the area of ion implantation, a PhD in ion implantation and semiconductors and a MS in nuclear power from Surrey University in England and a BS in physics from the Imperial College of London.

*Mr. Aebi* has served as Chief Technology Officer of the Intevac Photonics business since August 2006. Previously, Mr. Aebi served as President of the Photonics Division from July 2000 to July 2006 and as General Manager of the Photonics Division since May 1995. Mr. Aebi was elected as a Vice President of the Company in September 1995. From 1988 through 1994, Mr. Aebi was the Engineering Manager of the night vision business

Intevac acquired from Varian Associates in 1991, where he was responsible for new product development in the areas of advanced photocathodes and image intensifiers. Mr. Aebi holds a BS in physics and an MS in electrical engineering from Stanford University.

*Mr. Birt* joined Intevac in September 2004 and currently serves as Vice President, Manufacturing and Customer Support of the Equipment Products Division. Before joining Intevac, Mr. Birt was employed by Applied Materials from July 1992 to September 2004, most recently as Director, Field Operations/Quality North America. Mr. Birt holds a BS in electrical engineering from Texas A&M University.

*Mr. Bluck* rejoined Intevac as Vice President, Technology of the Equipment Products Division in August 2004. Mr. Bluck had previously worked at Intevac from December 1996 to November 2002 in various engineering positions. The business unit Mr. Bluck worked for was sold to Photon Dynamics in November 2002, and he was employed there as Vice President, Rapid Thermal Process Product Engineering until August 2004. Mr. Bluck holds a BS in physics from San Jose State University.

*Ms. Burk* joined Intevac in May 2000 and currently serves as Vice President of Human Resources. Prior to joining Intevac, Ms. Burk served as Human Resources Manager of Moen, Inc. from 1999 to 2000 and as Human Resources Manager of Lawson Mardon from 1994 to 1999. Ms. Burk holds a BS in sociology from Northern Illinois University.

*Mr. Justyn* has served as Vice President of Operations, Intevac Photonics from October 2008. Mr. Justyn served as Vice President, Equipment Manufacturing from April 1997 to October 2008. Mr. Justyn joined Intevac in February 1991 and has served in various roles in our Equipment Products Division and our former night vision business. Mr. Justyn holds a BS in chemical engineering from the University of California, Santa Barbara.

*Mr. Maffucci* joined Intevac in November 2007 as Managing Director of Intevac s Creative Display Systems subsidiary and currently serves as Vice President of Strategic Development, Intevac Vision Systems. Mr. Maffucci was the co-founder, Vice President and Chief Operating Officer of Creative Display Systems until its acquisition by Intevac in 2007. Prior to founding Creative Display Systems, Mr. Maffucci worked for Rockwell-Collins Optronics / Kaiser Electro-Optics from 1993 to 2006 in a variety of executive-level management positions where his most recent position was Sr. Director, Displays Business Unit. Mr. Maffucci holds a BS in Mechanical Engineering from the University of California, Davis.

**Available Information**

Intevac s website is *http://www.intevac.com.* Intevac makes available free of charge, on or through its website, its annual, quarterly and current reports, and any amendments to those reports, as soon as reasonably practicable after electronically filing such reports with, or furnishing them to, the SEC. This website address is intended to be an inactive textual reference only and none of the information contained on Intevac s website is part of this report or is incorporated by reference herein.

**Trade Marks**

200 Lean®, AccuLuber , DeltaNu®, EBAPS®, ENERGi , ExaminerR , I-Port , LEAN SOLAR , LithoVue®, MicroVista®, LNA®, NanoVista , NanoTexture Etch, NightVista®, Night Port , PHARMA-ID , and RAPID®, and other, are our trademarks.

**Item 1A.** ***Risk Factors***

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

***The industries we serve are cyclical, volatile and unpredictable.***

The majority of our revenue is derived from the sale of equipment used to manufacture commodity technology products such as disk drives and PV solar cells. 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 severely depressed from mid-1998 until mid-2003 and grew rapidly from 2004 through 2006, followed by a downturn in the cycle in late 2007 which continued through 2009. The number of new systems delivered increased in 2010 as customers increased their production capacity in response to increased demand for digital storage, but decreased in 2011 and 2012, 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. For example, while we previously believed that our sales would continue to be depressed through 2012, we now believe that the cycle will continue through at least 2013.

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, customization of our products, and installation of evaluation systems in the factories of our prospective customers. We do not enter into long-term contracts with our customers, and until an order is actually submitted by a customer there is no binding commitment to purchase our systems.

Intevac Photonics business is also subject to long sales cycles because many of its products, such as our military imaging products, often must be designed into the customers end products, which are often complex state-of-the-art products. These development cycles are 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.

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.

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, notebook personal computers 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.

***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 PV equipment market, Intevac faces competition from large established competitors including Applied Materials, Centrotherm Photovoltaics, Amtech, Jusung and Von Ardenne. In the market for our military imaging products we experience competition from companies such as ITT Exelis 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.

***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 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 system, our LEAN 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 market. 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.

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

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

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, cyclicality and other factors in the markets for computer systems, storage subsystems and consumer electronics containing disks our customers produce with our systems; (2) delays or problems in the introduction and acceptance of our new products, or delivery of existing products; (3) timing of orders, acceptance of new systems by our customers or cancellation of those orders; (4) new products, services or

technological innovations by our competitors or us; (5) changes in our manufacturing costs and operating expense; (6) changes in general economic, political, stock market and industry conditions; and (7) any failure of our operating results to meet the expectations of investment research analysts or investors.

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.

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

Economic conditions worldwide have contributed to decreased spending by our customers and a slowdown in the hard disk drive industry. These factors have adversely impacted our operating results and have caused us to be cautious about our future outlook. Our customers also continue to remain cautious about the economy. Negative macroeconomic and global recessionary factors, further volatility or disruption in the capital and credit markets or further uncertainty or weakening in key markets could negatively impact spending for our products and may materially adversely affect our business, operating results and financial condition.

In addition, while we intend to finance operations with existing cash and cash flow from operations, if necessary, we may require financing to support our continued operations. Due to the existing uncertainty in the capital and credit markets, our access to capital may not be available on terms acceptable to us or at all.

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

Many of our products, especially Intevac Photonics products, require export licenses from U.S. government agencies under the Export Administration Act, the Trading with the Enemy Act of 1917, the Arms Export Act of 1976 or the International Traffic in Arms Regulations. These regulations limit the potential market for some of our products. We can give no assurance that we will be successful in obtaining all the licenses necessary to export our products. Heightened government scrutiny of export licenses for defense related products has resulted in lengthened review periods for our license applications. Exports to countries that are not considered by the U.S. government to be allies are likely to be prohibited, and even sales to U.S. allies may be limited. Failure to 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 Intevac Photonics business is dependent on U.S. government contracts, which are subject to fixed pricing, immediate termination and a number of procurement rules and regulations.***

We sell 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 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. 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.

Intevac enjoys a tax holiday in Singapore for a portion of its business through the tax years ending in 2015. The tax holiday provides a lower income tax rate on certain classes of income so long as certain thresholds of business investment and employment levels are met in Singapore. We may lose our eligibility for such benefits if, among other things, these requirements are not met or if Intevac incurs net losses in Singapore for which it cannot claim a deduction. Loss of these tax benefits could result in our income in Singapore being taxed at the statutory rate of 17% instead of the agreed Pioneer Tax Holiday rate of 0%. A loss of all or part of these tax benefits would adversely affect our results of operations and cash flows.

We booked significant tax benefits in 2008, 2009, and 2011 based on our belief that we could both carry back losses and tax credits to years Intevac paid income taxes and carry forward losses and tax credits to future years where we believed we would generate taxable income. In 2012, the Company established a $23.4 million non-cash valuation allowance against certain of its U.S. deferred tax assets based upon an evaluation of all available objectively verifiable evidence, including but not limited to the cumulative loss incurred over the three-year period ended December 31, 2012 by the Company s U.S. operations. The establishment of the non-cash valuation allowance on the Company s U.S. deferred tax assets did not have any impact on its cash, nor does such an allowance preclude the Company from utilizing its tax losses, tax credits or other deferred tax assets in future periods.

Intevac will need to generate approximately $44.2 million of taxable income in Singapore in order to fully realize the foreign deferred tax assets, recorded as of December 31, 2012. If our expectations of future income are incorrect, we could be required to establish additional valuation allowance against some or the entire remaining deferred tax assets which are primarily attributable to our Singapore operation.

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

The majority of our revenues 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, Wyoming and Singapore and international customer support offices in Singapore, Taiwan, 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.

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, including the weakening relative position of the U.S. dollar; (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. See Note 6 Goodwill and Purchased Intangible Assets, Net in the Notes to the Consolidated Financial Statements for additional information related to impairment of goodwill and intangible assets.

***Our success is dependent on recruiting and retaining a highly talented work force.***

Our employees are vital to our success, and our key management, engineering and other employees are difficult to replace. We generally do not have employment contracts with our key employees. Further, we do not maintain key person life insurance on any of our employees. The expansion of high technology companies worldwide has increased demand and competition for qualified personnel, and has made companies increasingly protective of prior employees. It may be difficult for us to locate employees who are not subject to non-competition agreements and other restrictions.

The majority of our U.S. operations are located in California where the cost of living and of recruiting employees is high. 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 given recent economic conditions.

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

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

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

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

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

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

We have completed a number of acquisitions during our operating history. For example, in 2007, we acquired certain assets of DeltaNu, LLC and certain assets of Creative Display Systems, LLC, in 2008 we acquired certain assets of OC Oerlikon Balzers Ltd., in 2010 we acquired the outstanding shares of SIT and in 2012 we completed the sale of certain semiconductor mainframe technology assets to Brooks. 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.

***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 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 December 31, 2012, 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.

**Item 1B.** ***Unresolved Staff Comments***

None.

**Item 2.** ***Properties***

Intevac maintains its corporate headquarters in Santa Clara, California. The location, approximate size and type of facility of the principal properties are listed below. Intevac leases all of its properties and does not own any real estate.

| Location | Square Footage | Principal Use |
|---|---|---|
| Santa Clara, CA | 169,583 | Corporate Headquarters; Equipment and Intevac Photonics Marketing, Manufacturing, Engineering and Customer Support |
| Fremont, CA | 11,973 | Intevac Photonics Sensor Fabrication |
| Laramie, WY | 12,000 | Intevac Photonics Raman Spectrometer Manufacturing |
| Carlsbad, CA | 10,360 | Intevac Photonics Micro Display Product Manufacturing |
| Singapore | 31,947 | Equipment Manufacturing and Customer Support |
| Malaysia | 1,291 | Equipment Customer Support |
| Taiwan | 3,003 | Equipment Customer Support |
| Shenzhen, China | 2,568 | Equipment Customer Support |

Intevac considers these properties adequate to meet its current and future requirements. Intevac regularly assesses the size, capability and location of its global infrastructure and periodically makes adjustments based on these assessments.

**Item 3.** ***Legal Proceedings***

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

**Item 4.** ***Mine Safety Disclosures***

Not applicable.

**PART II**

**Item 5.** ***Market for Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities***

**Price Range of Common Stock**

Intevac common stock is traded on The Nasdaq Stock Market (NASDAQ Global Select) under the symbol IVAC. As of February 22, 2013, there were 98 holders of record. In fiscal years 2012 and 2011, Intevac did not declare or pay cash dividends to its stockholders. Intevac currently has no plans to declare or pay cash dividends.

The following table sets forth the high and low closing sale prices per share as reported on The Nasdaq Stock Market for the periods indicated.

| | High | Low |
|---|---|---|
| Fiscal 2012: | | |
| First Quarter | $ 9.14 | $ 7.33 |
| Second Quarter | 8.76 | 7.14 |
| Third Quarter | 7.83 | 5.10 |
| Fourth Quarter | 6.01 | 4.39 |
| Fiscal 2011: | | |
| First Quarter | $ 15.26 | $ 11.03 |
| Second Quarter | 12.47 | 9.43 |
| Third Quarter | 10.21 | 6.42 |
| Fourth Quarter | 8.55 | 6.11 |

**Recent Sales of Unregistered Securities**

None.

**Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

None.

**Performance Graph**

The following graph compares the cumulative total stockholder return on Intevac s Common Stock with that of the NASDAQ Stock Market Total Return Index, a broad market index published by the Center for Research in Security Prices ( CRSP ), and the NASDAQ Computer Manufacturers Stock Total Return Index compiled by CRSP. The comparison for each of the periods assumes that $100 was invested on December 31, 2007 in Intevac s Common Stock, the stocks included in the NASDAQ Stock Market Total Return Index and the stocks included in the NASDAQ Computer Manufacturers Stock Total Return Index. These indices, which reflect formulas for dividend reinvestment and weighting of individual stocks, do not necessarily reflect returns that could be achieved by individual investors.

**COMPARISON OF CUMULATIVE TOTAL RETURN SINCE DECEMBER 31, 2007**

**AMONG INTEVAC, NASDAQ STOCK MARKET TOTAL RETURN INDEX AND**

**NASDAQ COMPUTER MANUFACTURERS STOCK TOTAL RETURN INDEX**

| | 12/31/07 | 12/31/08 | 12/31/09 | 12/31/10 | 12/31/11 | 12/31/12 |
|---|---|---|---|---|---|---|
| Intevac, Inc. | $ 100 | $ 35 | $ 79 | $ 96 | $ 51 | $ 31 |
| Nasdaq Stock Market Total Return Index | 100 | 61 | 88 | 104 | 105 | 124 |
| Nasdaq Computer Manufacturers Total Return Index | 100 | 42 | 92 | 132 | 155 | 196 |

**Item 6.** ***Selected Financial Data***

The following selected financial information has been derived from Intevac s historical audited consolidated financial statements and should be read in conjunction with the consolidated financial statements, the accompanying notes and Management s Discussion and Analysis of Financial Condition and Results of Operations for the corresponding fiscal years.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | 2009 | 2008 |
| | (in thousands, except per share data) | | | | |
| Net revenues | $ 83,424 | $ 82,974 | $ 202,526 | $ 77,981 | $ 110,307 |
| Gross profit | $ 34,158 | $ 30,431 | $ 87,672 | $ 32,720 | $ 43,339 |
| Operating income (loss) | $ (42,533) | $ (30,741) | $ 31,238 | $ (17,347) | $ (30,471) |
| Net income (loss) | $ (55,319) | $ (21,975) | $ 28,049 | $ (10,077) | $ (15,345) |
| Earnings (loss) per share: | | | | | |
| Basic | $ (2.37) | $ (0.96) | $ 1.26 | $ (0.46) | $ (0.71) |
| Diluted | $ (2.37) | $ (0.96) | $ 1.22 | $ (0.46) | $ (0.71) |
| **At year end:** | | | | | |
| Total assets | $ 172,503 | $ 225,821 | $ 251,771 | $ 203,378 | $ 189,169 |

**Item 7.** ***Management s Discussion and Analysis of Financial Condition and Results of Operations***

Management s Discussion and Analysis (MD&A) is intended to facilitate an understanding of Intevac s business and results of operations. This MD&A should be read in conjunction with Intevac s Consolidated Financial Statements and the accompanying Notes to Consolidated Financial Statements included elsewhere in this Form 10-K. The following discussion contains forward-looking statements and should also be read in conjunction with the cautionary statement set forth at the beginning of this Form 10-K. MD&A includes the following sections:

*Overview:* a summary of Intevac s business, measurements and opportunities.

*Results of Operations:* a discussion of operating results.

*Liquidity and Capital Resources:* an analysis of cash flows, sources and uses of cash, contractual obligations and financial position.

*Critical Accounting Policies:* a discussion of critical accounting policies that require the exercise of judgments and estimates.

**Overview**

Intevac provides process manufacturing equipment solutions to the hard disk drive industry and high-productivity process manufacturing equipment to the PV industry. Intevac also provides sensors, cameras and systems for government applications such as night vision and long-range target identification and for commercial applications in the inspection, medical, scientific, pharmaceutical and security industries. Intevac s customers include manufacturers of hard disk drives and PV cells as well as the U.S. government and its agencies and contractors; and medical, scientific, pharmaceutical and other industrial companies. Intevac reports two segments: Equipment and Intevac Photonics. During the first quarter of 2012, Intevac sold certain assets comprising its semiconductor mainframe technology to Brooks. During the third quarter of 2012, Intevac wrote-off a promissory note receivable and a deferred profit liability related to certain thin-film PV equipment sold in a previous year due to the insolvency of the customer. During the fourth quarter of 2012, Intevac recorded a goodwill and intangibles impairment charge in the amount of $18.4 million and established a $23.4 million deferred tax valuation allowance against its U.S. deferred tax assets.

Product development and manufacturing activities occur in North America and Asia. Intevac has field offices in Asia to support its equipment customers. Intevac s equipment and service products are highly technical and 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 worldwide demand for hard disk drives, which in turn depends on the growth in digital data creation and storage, the rate of areal density improvements, the end-user demand for personal computers, enterprise data storage, including on-line, cloud storage and near-line applications, personal audio and video players and video game platforms that include such drives. Demand for Intevac s equipment is impacted by Intevac s customers relative market share positions and production capacity needs. Intevac continues to execute its strategy of equipment diversification into new markets by introducing products for PV solar cell manufacturing. Intevac believes that expansion into this market, which is significantly larger than the hard disk drive deposition equipment market, 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 and PV cells, as well as other factors such as global economic conditions and technological advances in fabrication processes.

| Fiscal Year | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
|---|---|---|---|---|---|
| | (in thousands, except percentages and per share amounts) | | | | |
| Net revenues | $ 83,424 | $ 82,974 | $ 202,526 | $ 450 | $ (119,552) |
| Gross profit | 34,158 | 30,431 | 87,672 | 3,727 | (57,241) |
| Gross margin percent | 40.9% | 36.7% | 43.3% | 4.2 points | (6.6) points |
| Net income (loss) | (55,319) | (21,975) | 28,049 | (33,344) | (50,024) |
| Earnings (loss) per diluted share | $ (2.37) | $ (0.96) | $ 1.22 | $ (1.41) | $ (2.18) |

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Fiscal 2010 financial results reflected improved conditions as Intevac s Equipment customers took delivery of systems to increase their production capacity in response to the increasing demand for hard drives resulting from a general increasing demand for digital storage in multiple applications. In fiscal 2010 Intevac also invested heavily in the development of its PV solar manufacturing products and in late 2010, Intevac acquired SIT to develop ion implementation systems for PV cell manufacturing. Selling, general and administrative expenses during fiscal 2010 included variable compensation expenses, legal expenses associated with an arbitration proceeding covering Intevac s holdings of auction rate securities ( ARS ) and transaction costs associated with the acquisition of SIT.

Fiscal 2011 financial results reflected a challenging environment that resulted from consolidations in the hard drive industry, a natural disaster (flood) in Thailand, and the impact of U.S. government defense budget delays. Net revenues during fiscal 2011 reflected lower equipment sales to hard drive manufacturers and lower Intevac Photonics contract research and development ( R&D ) offset in part by higher Intevac Photonics military product sales. Intevac sold fewer 200 Lean systems in fiscal 2011, as Intevac s hard drive customers delayed equipment purchases during the extended regulatory approval process for the two acquisitions by Seagate and Western Digital. Also Intevac s hard drive customers had invested heavily in increased production capacity in the previous year, which met some of their 2011 capacity needs. Finally, floods in Thailand resulted in supply chain disruptions for Intevac s hard drive customers. During fiscal 2011, Intevac also continued its efforts to diversify the equipment business and recognized the first revenue on its PV and semiconductor products. For fiscal 2011, Intevac Photonics product revenue from low-light sensors and cameras increased; however, contract R&D revenue declined as certain R&D contracts had been completed in the prior year and contract funding for several large programs was impacted due to delays in U.S. government defense budget approvals. The fiscal 2011 net loss reflected lower net revenues and increased operating expenses from the inclusion of SIT which was acquired in the fourth quarter of fiscal 2010, offset in-part by reduced variable compensation expenses and recognition of an income tax benefit. During fiscal 2011, the Company did not record compensation expense in association with its profit sharing and executive incentive variable compensation programs as a result of being in a loss position.

Fiscal 2012 financial results reflected a challenging environment as the global economic slowdown resulted in lower sales of personal computers and consumer electronic applications and lower hard drive unit shipments by hard drive manufacturers. Personal computer sales were also negatively impacted by changing consumer trends toward higher usage of mobile and tablet devices. Although the hard drive industry continues to expect growth in the enterprise data storage market segment which includes on-line, centralized storage or cloud storage and near-line applications, the transition to cloud storage resulted in lower hard drive shipments in the near term. With hard drive unit shipments down year over year, the Company shipped only two 200 Lean systems for capacity during 2012. However, Intevac continues to believe that long-term demand for hard disk drives will increase, driven by growth in demand for digital storage, declining growth rate in areal density improvements, the need for corporations to replace and update employee computers, increased information technology spending to support the transition to cloud storage and the proliferation of personal computers into emerging economies. The number of disk manufacturing systems needed to support this growth as well as future technology transitions and improvements is expected to vary from year to year depending on the factors noted above. In fiscal 2012, Intevac completed a customer qualification on its PV Etch manufacturing product as well as delivered two beta ion implant systems that are under-going qualification. During the first quarter of 2012, Intevac discontinued offering products to the semiconductor industry and sold certain assets which comprised its semiconductor mainframe technology to Brooks.

In fiscal 2012, Intevac Photonics business levels grew driven primarily by the recovery of the contract R&D business, as several key U.S. defense programs received budgetary funding in late 2011 and Intevac was awarded a major development contract with the U.S. Army in the second quarter of 2012. The U.S. military continues to develop night vision solutions based on Intevac s digital low-light sensor technology. Substantial growth in future Intevac Photonics revenues is dependent on the proliferation of Intevac s technology into major military programs, continued defense spending, the ability to obtain export licenses for foreign customers, obtaining production subcontracts for these programs, and Intevac s development and market acceptance of commercial products.

The fiscal 2012 net loss reflected slightly higher net revenues, improved gross margins, increased operating expenses from the inclusion of the $18.4 million goodwill and intangibles impairment charge and the $3.0 million write-off of a promissory note receivable and higher income tax expenses from the establishment of a $23.4 million deferred tax valuation allowance. During fiscal 2012, the Company did not record compensation expense in association with its profit sharing and executive incentive variable compensation programs as a result of being in a loss position.

In fiscal 2013, Intevac expects that the effect of macro-economic environment conditions on demand for personal computers from consumers and corporations, the continued proliferation of tablets and the increase in centralized storage will continue to negatively impact the hard drive equipment business. The Company therefore expects that capacity shipments of Intevac equipment to hard disk drive manufacturers will be approximately at the same levels as 2012. In 2013, Intevac expects increased sales of PV equipment as Intevac completes its production qualifications, which Intevac expects will lead to production orders and additional customers in the solar market. For fiscal 2013, Intevac expects that Intevac Photonics business levels are expected to be flat to up slightly from 2012 as the business completes its major development contract with the U.S. Army in advance of the first large scale production shipments that will begin in late 2013.

**Results of Operations**

*Net revenues*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | | | (in thousands) | | |
| Equipment | $ 52,538 | $ 54,878 | $ 168,252 | $ (2,340) | $ (113,374) |
| Intevac Photonics | | | | | |
| Contract R&D | 15,755 | 7,124 | 18,309 | 8,631 | (11,185) |
| Products | 15,131 | 20,972 | 15,965 | (5,841) | 5,007 |
| | 30,886 | 28,096 | 34,274 | 2,790 | (6,178) |
| Total net revenues | $ 83,424 | $ 82,974 | $ 202,526 | $ 450 | $ (119,552) |

Net revenues consist primarily of sales of equipment used to manufacture thin-film disks and PV cells, and related equipment and system components; revenue from contract R&D related to the development of electro-optical sensors, cameras and systems; and sales of low-light imaging products and Raman spectroscopy instruments.

The decrease in Equipment revenues in 2012 was due primarily to a decrease in the number of 200 Lean systems delivered to hard disk drive manufacturers. Intevac delivered two 200 Lean systems in 2012 compared to three 200 Lean systems in 2011 and compared to twenty-six 200 Lean systems in 2010. During fiscal 2012 Intevac recognized revenue on its first LEAN SOLAR NanoTexture etch system for PV applications. During fiscal 2011, Intevac recognized revenue on the first LEAN SOLAR deposition systems and from its semiconductor products. During the first quarter of 2012, Intevac discontinued offering products to the semiconductor industry and sold certain assets which comprised its semiconductor mainframe technology to Brooks. Revenues from disk equipment technology upgrades and spare parts increased in 2012 versus 2011 as Intevac s customers invested in upgrades for 200 Lean systems which increase the efficiency of target material sputtered onto hard disk drives. Revenues from disk equipment technology upgrades and spare parts decreased in 2011 versus 2010 as Intevac s customers delayed equipment purchases due to the pending industry consolidation as well as reduced need for upgrades in light of the level of new equipment purchased in fiscal 2010.

Equipment revenues in 2013 are expected to increase slightly from 2012 levels due to increased revenue from Intevac s new PV equipment products partially, offset by a reduction in technology upgrade sales for the hard drive installed base. Increases in system sales for the hard drive industry will be driven by the need for incremental manufacturing capacity which is currently in an over-supply condition that is expected to remain through 2013. Increases in PV equipment products will be driven by the adoption of new vacuum technologies in the manufacturing of solar cells for both existing and new production lines.

Intevac Photonics revenues increased by 9.9% to $30.9 million in 2012 over 2011 and decreased by 18.0% to $28.1 million in 2011 from 2010. Contract R&D revenue in 2012 increased as a result of a higher volume of contracts related to two large U.S. government defense programs and due to the continued expansion of Intevac s low-light camera and sensor products in military applications. The contract R&D revenue decrease in 2011 was the result of a lower volume of contracts due to the completion of several of Intevac Photonics large development contracts in 2010 and delays in U.S. government defense budget approvals. Photonics product revenue decreased in 2012 as a result of lower sales of low-light camera modules and a lower level of shipment volumes for long-range imaging products as well as lower sales of Raman spectroscopy products for commercial applications. Product revenues increased in 2011 due to higher sales of low-light sensors and cameras used in military night vision and long-range imaging as well as commercial applications such as Intevac s near-eye display products. In 2013, Intevac Photonics revenue is expected to increase slightly from 2012 levels. Substantial growth in future Intevac Photonics revenues is dependent on the proliferation of Intevac s technology into major military programs, continued defense spending, the ability to obtain export licenses for foreign customers, obtaining production subcontracts for these programs, and Intevac s development and market acceptance of commercial products.

Intevac s backlog of orders at December 31, 2012 was $35.2 million, as compared to $32.9 million at December 31, 2011 and $46.7 million at December 31, 2010. Equipment backlog at December 31, 2012 was $8.9 million compared to $17.9 million at December 31, 2011 and $27.3 million at December 31, 2010. Intevac Photonics backlog at December 31, 2012 was $26.3 million as compared to $15.0 million at December 31, 2011 and $19.4 million at December 31, 2010. Equipment backlog at December 31, 2012 did not include any 200 Lean or LEAN SOLAR systems, as compared to one LEAN SOLAR system at December 31, 2011, and two 200 Lean systems and two LEAN SOLAR systems at December 31, 2010.

Significant portions of Intevac s revenues in any particular period have been attributable to sales to a limited number of customers. The following customers accounted for at least 10 percent of Intevac s consolidated net revenues in 2012, 2011, and/or 2010.

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Seagate Technology | 51% | 41% | 40% |
| U.S. Government | 10% | * | * |
| HGST | * | 12% | 26% |
| Fuji Electric | * | * | 12% |

* Less than 10%

The magnetic disk manufacturing industry consists of a small number of large manufacturers. Sales in 2012 to the U.S. government represent contract R&D under contracts with the U.S. Army and the U.S. Navy.

International sales totaled $52.6 million, $54.1 million, and $155.0 million in 2012, 2011, and 2010, respectively, accounting for 63%, 65%, and 77% of net revenues. The decrease in international sales in 2012 vs. 2011 was primarily due to lower net revenues from Intevac Photonics digital night-vision camera sold to a NATO customer. The decrease in international sales in 2011 vs. 2010 was primarily due to decreases in net revenues from disk sputtering systems. Substantially all of Intevac s international sales are to customers in Asia, which includes products shipped to overseas operations of U.S. companies.

*Gross margin*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | (in thousands, except percentages) | | | | |
| Equipment gross profit | $ 23,594 | $ 22,318 | $ 79,472 | $ 1,276 | $ (57,154) |
| % of Equipment net revenues | 44.9% | 40.7% | 47.2% | | |
| Intevac Photonics gross profit | $ 10,564 | $ 8,113 | $ 8,200 | $ 2,451 | $ (87) |
| % of Intevac Photonics net revenues | 34.2% | 28.9% | 23.9% | | |
| Total gross profit | $ 34,158 | $ 30,431 | $ 87,672 | $ 3,727 | $ (57,241) |
| % of net revenues | 40.9% | 36.7% | 43.3% | | |

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

Equipment gross margin was 44.9% in 2012 compared to 40.7% in 2011 and 47.2% in 2010. Fiscal 2012 gross margins improved over fiscal 2011 due primarily to a higher mix of upgrades and spares shipments as well as higher system margins, offset in part by lower factory utilization and higher provisions for inventory reserves. Fiscal 2011 gross margins declined over fiscal 2010 due to lower volume and unabsorbed factory utilization costs. Gross margins in the Equipment business 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.

Intevac Photonics gross margin was 34.2% in 2012 compared 28.9% in 2011 and 23.9% in 2010. The improvement in gross margin in 2012 resulted primarily from cost reductions associated with digital night-vision products and warranty offset by slightly lower margins on contract R&D. The increase in gross margin in 2011 resulted primarily from improved margins associated with Intevac Photonics high volume digital night vision production shipments for a NATO customer and lower warranty provisions. Manufacturing costs for the digital night vision product decreased in 2012 and 2011 as a result of cost reductions and yield improvements.

*Research and development*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | | | (in thousands) | | |
| Research and development expense | $ 31,762 | $ 34,287 | $ 27,918 | $ (2,525) | $ 6,369 |

Research and development expense consists primarily of salaries and related costs of employees engaged in and prototype materials used in ongoing research, design and development activities for PV cell manufacturing equipment, disk sputtering equipment, semiconductor equipment and Intevac Photonics products. During the first quarter of 2012, Intevac sold certain assets comprising its semiconductor mainframe technology to Brooks and no longer performs research and development activities for semiconductor equipment.

Research and development spending decreased for Equipment during 2012 as compared to 2011 due primarily to lower spending on prototype materials for PV development and the discontinuance of semiconductor equipment development. Research and development spending increased for Equipment during 2011 as compared to 2010 due primarily to increased PV development and the inclusion of SIT which was acquired in the fourth quarter of fiscal 2010.

Research and development spending decreased for Intevac Photonics during 2012 as compared to 2011 due to a higher volume of billable contract R&D efforts and cost containment efforts taken early in 2012. Research and development spending increased for Intevac Photonics during 2011 as compared to 2010 due primarily to an increase in yield improvement efforts, offset in part by cost containment efforts. Research and development expenses do not include costs of $11.3 million, $4.9 million, and $12.9 million, in 2012, 2011, and 2010, respectively, which are related to customer-funded contract R&D programs and therefore included in cost of net revenues.

*Selling, general and administrative*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | | | (in thousands) | | |
| Selling, general and administrative expense | $ 25,700 | $ 26,844 | $ 28,516 | $ (1,144) | $ (1,672) |

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs. All domestic sales and the majority of international sales of disk sputtering products in Asia are made through Intevac s direct sales force. Intevac also sells its equipment through distributors in Japan and China. Intevac has offices in Singapore, Malaysia and China to support Intevac s equipment customers in Asia.

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Selling, general and administrative expenses decreased in 2012 over the amount spent in 2011 due primarily to the lower charges associated with the change in the fair value of the contingent consideration obligations related to the SIT acquisition and cost containment efforts. Selling, general and administrative expenses decreased in 2011 over the amount spent in 2010 due primarily to the reduction in variable compensation accruals offset in part by acquisition-related charges and increased equity compensation expense. Selling, general and administrative expense include costs of $(219,000), $1.2 million and $108,000, in 2012, 2011 and 2010, respectively, in charges associated with the change in the fair value of the contingent consideration obligations related to the SIT acquisition.

*Bad debt expense*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | | | (in thousands) | | |
| Bad debt expense | $ 3,017 | $ 41 | $ | $ 2,976 | $ 41 |

During the third quarter of 2012 Intevac wrote off a promissory note receivable and the related deferred profit liability from the sale of certain thin-film PV equipment in a previous year and incurred bad debt expense of $3.0 million due to the insolvency of the customer. See Note 5 Balance Sheet Details in the notes to the consolidated financial statements for additional information related to the write-off.

*Impairment of goodwill and intangibles*

Goodwill and Intevac s indefinite life intangible assets are tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill and indefinite life intangible assets may be impaired. In the fourth quarter of 2012, Intevac performed its 2012 annual assessment of impairment. Intevac s reporting units for goodwill impairment testing purposes are consistent with the reportable segments: Equipment and Intevac Photonics. Intevac tested goodwill for possible impairment by first determining the fair value of the related reporting unit and then comparing this value to the recorded net assets of the reporting unit.

The process of evaluating the potential impairment of goodwill is highly subjective and requires significant judgment. Intevac used two valuation methodologies, the market approach and the income approach, to determine the fair value for its reporting units. In the Equipment reporting unit the market approach was weighted at 75% and the income approach was weighted at 25% due to the uncertainty in the near term forecast. In the Intevac Photonics reporting unit, the income approach and the market approach were given equal weighting. Under the income approach, the fair value of each reporting unit was calculated based on the present value of estimated future cash flows, which were arrived at by evaluating historical trends, current budgets, operating plans and industry data. Estimates of the future cash flows associated with the businesses are critical to these assessments. The assumptions used in the fair value calculation included revenue growth rates, operating margins, risk adjusted discount rates and future economic and market conditions. The market approach looked at the valuations of comparable public companies which Intevac selected based upon similar industries and products. Intevac then evaluated the reasonableness of the fair value calculations of the reporting units by reconciling the total of the fair values of the two reporting units to Intevac s total market capitalization, taking into account an appropriate control premium. Intevac compared the carrying value of the reporting units to the fair value calculations.

The results of step one of the goodwill impairment analysis indicated that the fair values of both the Equipment and Intevac Photonics reporting units were less than their carrying values and potential impairment existed. Intevac completed the second step of the goodwill impairment analysis and determined that there would be no remaining implied value attributable to goodwill in either reporting unit and accordingly, Intevac wrote off all of the goodwill which amounted to $10.5 million in the Equipment reporting unit and $7.9 million in the Intevac Photonics reporting unit.

In the second half of 2012, the Company experienced a significant decline in its stock price which resulted in the Company s market capitalization falling significantly below the recorded value of its consolidated net assets. The impairment charge in the Equipment reporting unit was primarily driven by lower projected results

compared to prior forecasts. In the third quarter of fiscal 2012, hard drive shipments were below industry expectations and forecasted hard drive units were expected to be down year over year for the second consecutive year. Also the timing of Intevac s penetration strategy for the PV market was impacted by the overcapacity of PV manufacturers and the oversupply of solar panels in the market. In light of these events, Intevac lowered its near term forecast for the Equipment reporting unit. The impairment charge in the Intevac Photonics reporting unit was primarily driven by adverse equity market conditions in the Photonics industry due to concerns over lower U.S. government military spending and budget constraints that caused a decrease in current market multiples compared with prior years testing.

Intevac acquired in-process research and development ( IPR&D ) of $4.0 million in connection with the acquisition of SIT in November 2010. The fair value of the IPR&D was determined through estimates and valuation techniques based on the terms of the acquisition. This IPR&D project is the development of Intevac s ENERGi ion implantation process technology module for the LEAN SOLAR platform to be used in the manufacturing of PV solar cells. Intevac expects to complete development on this project in the first half of fiscal 2013. Upon completion of development and establishment of technological feasibility, Intevac will determine and begin amortization of the acquired IPR&D over its useful life.

In conjunction with the annual impairment review, the Company assessed the valuation of the IPR&D from the SIT acquisition. For IPR&D, the review involved determining the present value of future cash flows from the resulting product based on estimates, judgments, and assumptions that management believes are appropriate for the circumstances. Based upon updated management projections related to the IPR&D and on a discounted cash flow model, Intevac determined the fair value of the IPR&D exceeded its carrying value.

Intevac also performed the annual impairment review of a tradename, an indefinite life intangible asset, during the fourth quarter of 2012 using a discounted cash flow model and the relief-from-royalty method. Based on this review, Intevac determined the carrying value of the tradename exceeded its fair value and recorded an impairment charge of $30,000.

Intevac will continue to evaluate the carrying value of intangible assets and if it is determined that there is a potential impairment; Intevac may record additional charges which would adversely affect its financial results. For further details, see note 6 in the notes to the consolidated financial statements.

*Gain on sale of mainframe technology*

On January 6, 2012, the Company sold certain assets including intellectual property and residual assets which comprised its semiconductor mainframe technology for $3.0 million in cash to Brooks and recorded a gain of $2.2 million. See Note 8 Sale of Mainframe Technology in the notes to the consolidated financial statements for additional information related to the gain on sale of the mainframe technology.

*Interest income and other, net*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | | | (in thousands) | | |
| Interest income and other, net | $ 454 | $ 635 | $ 773 | $ (181) | $ (138) |

Interest income and other, net in 2012 included $806,000 of interest income on investments partially offset by $381,000 in realized losses on the sale of ARS and $78,000 of foreign currency losses. Interest income and other, net in 2011 included $847,000 of interest income on investments and a gain of $109,000 related to the sale of fixed assets partially offset by $308,000 in realized losses on the sale of ARS that were sold to the issuers at less than par value as part of tender offers and $32,000 of foreign currency losses. Interest income and other, net in 2010 included $899,000 of interest income on investments, a gain of $481,000 related to the remeasurement of Intevac s pre- acquisition equity interest in SIT at the acquisition-date fair value, partially offset by $520,000 of foreign currency losses and $87,000 in net other expense. The decreases in interest income in 2012 and 2011 were driven by lower interest rates on Intevac s investments.

*Provision for (benefit from) income taxes*

| | Years Ended December 31, | | | | |
|---|---|---|---|---|---|
| | 2012 | 2011 | 2010 | Change 2012 vs. 2011 | Change 2011 vs. 2010 |
| | | | (in thousands) | | |
| Provision for (benefit from) income taxes | $ 13,240 | $ (8,131) | $ 3,962 | $ 21,371 | $ (12,093) |

Intevac s effective income tax rate was (31.5%) for fiscal 2012, 27.0% for fiscal 2011, and 12.4% for fiscal 2010. 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 accordingly.

Intevac enjoys a tax holiday in Singapore for a portion of its business through the tax years ending in 2015. The tax holiday provides a lower income tax rate on certain classes of income and the agreement requires that certain thresholds of business investment and employment levels be met in Singapore in order to maintain this holiday.

Management assesses the available positive and negative evidence to estimate if sufficient future taxable income will be generated to use the existing deferred tax assets. A significant element of objective negative evidence evaluated was the cumulative loss incurred over the three-year period ended December 31, 2012. Such objective negative evidence limits the ability to consider other subjective evidence such as Intevac s projections for future growth. On the basis of this analysis and the significant objective negative evidence, for the year ended December 31, 2012, a valuation allowance of $23.4 million has been added against the U.S. deferred tax asset balance as it was determined that it was more likely than not that it will not be realized. The amount of the deferred tax asset considered realizable, however, could be adjusted if estimates of future taxable income during the carryforward period are increased, or if objective negative evidence in the form of cumulative losses is no longer present and additional weight may be given to subjective evidence such as our projections for growth.

As of December 31, 2012, Intevac has recorded a net deferred tax asset of $10.9 million. Of this amount, $3.4 million is in the U.S. federal jurisdiction and $7.5 million is recorded in Singapore. The realization of the deferred tax asset is primarily dependent on Intevac generating sufficient taxable income in future fiscal years. Management believes that sufficient positive evidence exists from historical operations and projections of taxable income in future years to conclude that it is more likely than not that the Company will realize its remaining deferred tax assets.

**Business Combination**

On November 19, 2010, Intevac acquired the outstanding shares of SIT, a privately-owned, development stage company, developing an ion implant module to be used in the manufacturing of PV solar cells. Intevac s primary reasons for this acquisition were to complement its existing product offerings and to provide opportunities for future growth. The preliminary aggregate purchase price was $12.4 million, which consisted of an initial cash payment totaling $2.7 million and contingent consideration obligations with a fair value of $9.7 million payable in cash based on the achievement of certain product development milestones achieved over a specified period and revenue earnout on Intevac s net revenue from commercial sales of certain products achieved over a specified period. On July 21, 2011, April 12, 2012, and July 1, 2012 Intevac made $2.4 million, $2.4 million and $956,000 in payments to the selling shareholders for achievement of the first, second and third milestones. The fourth and final milestone was not achieved on the targeted date outlined in the acquisition agreement and will not be paid. There is no remaining contingent consideration obligation associated with the milestone agreement at December 31, 2012. As of December 31, 2012, Intevac has not made any payments associated with the revenue earnout obligation.

For further details, see Note 7 of notes to consolidated financial statements.

**Recent Accounting Pronouncement**

In July 2012, the Financial Accounting Standards Board ( FASB ) amended its existing guidance for goodwill and other intangible assets. This authoritative guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. To perform a qualitative assessment, a company must identify and evaluate changes in economic, industry and company-specific events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. If a company determines that it is more likely than not that the fair value of such an asset exceeds its carrying amount, it would not need to calculate the fair value of the asset in that year. This authoritative guidance becomes effective for Intevac in the first quarter of fiscal 2013. The implementation of this authoritative guidance is not expected to have a material impact on Intevac s financial position or results of operations.

**Liquidity and Capital Resources**

At December 31, 2012, Intevac had $92.2 million in cash, cash equivalents, and investments compared to $114.8 million at December 31, 2011. During fiscal 2012, cash, cash equivalents and investments decreased by $22.7 million due primarily to cash used by operating activities, payment of acquisition-related contingent consideration and purchases of fixed assets partially offset by cash received from the sale of the mainframe technology and 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:

| | December 31, 2012 | December 31, 2011 |
|---|---|---|
| | (In thousands) | |
| Cash and cash equivalents | $ 24,261 | $ 23,560 |
| Short-term investments | 40,591 | 58,585 |
| Long-term investments | 27,317 | 32,677 |
| Total cash, cash-equivalents and investments | $ 92,169 | $ 114,822 |

Cash used by operating activities totaled $19.7 million in 2012 and $16.3 million in 2011. Cash generated by operating activities totaled $51.3 million in 2010. Lower operating cash flow in 2012 was a result of the net loss adjusted to exclude the effect of non-cash charges including, goodwill and intangible impairments, deferred taxes, depreciation, amortization, changes in the fair value of acquisition-related contingent consideration, bad debt expense and equity-based compensation. Higher levels of working capital also contributed to the decrease in cash from operating activities as Intevac made investments for next generation PV products. Intevac continues to carefully manage working capital.

Accounts receivable totaled $19.8 million at December 31, 2012 compared to $18.6 million at December 31, 2011. The number of days outstanding for Intevac s accounts receivable was 100 at December 31, 2012 compared to 88 at December 31, 2011. The increase in the receivable balance and days outstanding was due primarily to a higher level of unbilled receivables for contract R&D due to delays in approvals from the U.S. government. Net inventories totaled $26.2 million at December 31, 2012 compared to $18.1 million at December 31, 2011. Inventory turns were 1.7 in fiscal 2012 compared to 2.7 in fiscal 2011. The increase in the inventory balance and the decline in turns were due primarily to investments in inventories for next generation PV products including placing systems under evaluation agreements at customers. Accounts payable totaled $4.5 million at December 31, 2012 compared to $4.9 million at December 31, 2011. Customer advances decreased from $5.0 million at December 31, 2011 to $2.2 million at December 31, 2012.

Investing activities generated cash of $21.9 million in 2012, used cash of $70.2 million in 2011, and generated cash of $37.7 million in 2010. In 2012, proceeds from sales and maturities of investments, net of purchases, totaled $22.1 million. In 2011, purchases of investments, net of proceeds from sales and maturities, totaled $64.9 million. In 2010, proceeds from sales and maturities of investments, net of purchases, totaled $47.4 million. On January 6, 2012, the Company sold certain assets which comprised its semiconductor

mainframe technology for $3.0 million in cash to Brooks. During 2010, Intevac acquired the outstanding shares of SIT for a preliminary aggregate purchase price of $12.4 million, which consisted of an initial cash payment totaling $2.7 million and a contingent consideration obligation with a fair value of $9.7 million payable in cash. Capital expenditures were $3.3 million in 2012, $5.6 million in 2011, and $7.1 million in 2010.

Financing activities used cash of $1.5 million in 2012 and generated cash of $535,000 in 2011 and $2.9 million in 2010. In connection with the acquisition of SIT, Intevac agreed to pay up to an aggregate of $7.0 million in cash to the selling shareholders if certain milestones are achieved over a specified period. On July 21, 2011, April 12, 2012, and July 1, 2012 Intevac made $2.4 million, $2.4 million, and $956,000 in payments to the selling shareholders for achievement of the first, second and third milestones. The fourth and final milestone was not achieved on the targeted date outlined in the acquisition agreement and will not be paid. There is no remaining contingent consideration obligation associated with the milestone agreement at December 31, 2012. Subsequent to the SIT acquisition, Intevac paid in full $177,000 in notes payable to certain selling shareholders assumed upon the acquisition. The sale of Intevac common stock to Intevac s employees through Intevac s employee benefit plans provided $1.9 million in 2012, $2.9 million in 2011, and $2.8 million in 2010.

Intevac s investment portfolio consists principally of investment grade money market mutual funds, U.S. Treasury and agency securities, commercial paper, municipal bonds, corporate bonds and variable rate demand notes ( VRDNs ). 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.

Intevac previously held ARS that, due to their lack of liquidity, were categorized as Level 3 securities. Intevac did not hold any ARS at December 31, 2012. During 2012 Intevac sold ARS with a par value of $4.9 million, collected $4.5 million and recognized realized losses on the sales of $381,000. During 2011, Intevac participated in three tender offers, sold ARS with par values of $5.5 million, collected $5.2 million and recognized realized losses on the sales of $308,000. Additionally, during 2011, $500,000 of ARS were redeemed at par. On July 27, 2010, as a result of a favorable ruling from the Financial Industry Regulatory Authority arbitration panel, Intevac received $54.8 million from the repurchase of by Citigroup of previously held ARS at par including interest.

As of December 31, 2012, approximately $7.6 million of cash and cash equivalents and $7.6 million of investments 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 Intevac s cash requirements for the next 12 months. Intevac intends to undertake approximately $5.0 million $6.0 million in capital expenditures during the next 12 months.

**Contractual Obligations**

The following table summarizes Intevac s contractual obligations as of December 31, 2012:

| | | Payments due by period | | | |
|---|---|---|---|---|---|
| | **Total** | **< 1 Year** | **1 3 Years** | **3-5 Years** | **> 5 Years** |
| | | | **(in thousands)** | | |
| Operating lease obligations | $ 7,960 | $ 2,196 | $ 3,637 | $ 2,127 | $ |
| Purchase obligations and commitments[1] | 7,771 | 7,771 | | | |
| Other long-term liabilities[2, 4] | 90 | 90 | | | |
| Total[3, 4] | $ 15,821 | $ 10,057 | $ 3,637 | $ 2,127 | $ |

1 Purchase obligations include agreements to purchase goods or services that are enforceable and legally binding on Intevac and that specify all significant terms, including fixed or minimum quantities to be purchased; fixed, minimum or variable price provisions; and the approximate timing of the transaction. Purchase obligations exclude agreements that are cancelable without penalty. These purchase obligations are related principally to inventory and other items.

2 Intevac is unable to reliably estimate the timing of future payments related to uncertain tax positions; therefore, $4.3 million of unrecognized tax benefits has been excluded from the table above.

3 Total excludes contractual obligations already recorded on the consolidated balance sheet as current liabilities (except other long-term liabilities) and certain purchase obligations.

4 Total excludes contingent consideration that may be paid pursuant to asset purchases or business combinations.

**Off-Balance Sheet Arrangements**

As of December 31, 2012, Intevac did not have any material off-balance sheet arrangements (as defined in Item 303(a)(4)(ii) of Regulation S-K).

**Critical Accounting Policies**

The preparation of consolidated financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported. Note 1 of Notes to Consolidated Financial Statements describes the significant accounting policies used in the preparation of the consolidated financial statements. Certain of these significant accounting policies are considered to be critical accounting policies.

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

Estimates and assumptions about future events and their effects cannot be determined with certainty. Intevac bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as Intevac s operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they became 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. These uncertainties are discussed in the section above entitled Risk Factors. Based on a critical assessment of its 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 accounting principles generally accepted in the United States of America, and provide a meaningful presentation of Intevac s financial condition and results of operations.

Management believes that the following are critical accounting policies:

***Revenue Recognition***

Intevac recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have passed to Intevac s customer or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Intevac s shipping terms are customarily FOB shipping point or equivalent terms. Intevac s revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment, Intevac recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer acceptance; and (3) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred until delivery of the deferred elements. When a sales arrangement contains multiple elements, Intevac allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based

on its vendor specific evidence ( VSOE ) if available, third party evidence ( TPE ) if VSOE is not available, or best estimate of selling price ( ESP ) if neither VSOE nor TPE is available. Intevac generally utilizes the ESP due to the nature of its products. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements, usually split between delivery of the parts and installation on the customer s systems. In these cases, Intevac recognizes revenue for the relative sales price of the parts upon shipment and transfer of title, and recognizes revenue for the relative sales price of installation services when those services are completed. Revenue related to sales of spare parts is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services. In addition, Intevac uses the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in management s judgment the degree of collectibility is uncertain.

Intevac performs research and development work under various government-sponsored research contracts. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. Intevac considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on fixed-price contracts is recognized on a milestone method or percentage-of-completion method of contract accounting. For contracts structured as milestone agreements, revenue is recognized when a specified milestone is achieved, provided that (1) the milestone event is substantive in nature and there is substantial uncertainty about the achievement of the milestone at the inception of the agreement, (2) the milestone payment is non-refundable, and (3) there is no continuing performance obligations associated with the milestone payment. Any milestone payments received prior to satisfying these revenue recognition criteria are deferred. Intevac generally determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected through completion of the contract. When estimates of total costs to be incurred on a contract exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

***Inventories***

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

***Warranty***

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

***Income Taxes***

Intevac accounts for income taxes by recognizing deferred tax assets and liabilities using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities, net operating losses and tax credit carryforwards. Deferred tax assets are also reduced by a valuation allowance if it

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

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

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

***Valuation of IPR&D, Contingent Consideration, Goodwill and Other Intangible Assets***

The purchase price of an acquired business is allocated, as applicable, between IPR&D, other identifiable intangible assets, net tangible assets and goodwill. IPR&D is defined as the value assigned to those projects for which the related products have no alternative future use. Determining the portion of the purchase price allocated to IPR&D and other intangible assets requires the Company to make significant estimates. The amount of the purchase price allocated to IPR&D and other intangible assets is determined by estimating the future cash flows of each project or technology and discounting the net cash flows back to their present values. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. For IPR&D, these valuation methodologies include consideration of the risk of the project not achieving commercial feasibility.

Contingent consideration is recorded at the acquisition date at the estimated fair value of the contingent payments. The acquisition date fair value is measured based on the consideration expected to be transferred (probability-weighted), discounted back to present value. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. The fair value of the contingent consideration is remeasured at the estimated fair value at each reporting period with the change in fair value recognized as income or expense in the consolidated statements of operations.

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

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. For goodwill, Intevac performs a two-step impairment test. In the first step, Intevac compares the fair value of each reporting unit to its carrying value. Intevac s reporting units are consistent with the reportable segments identified in Note 13, based on the manner in which Intevac operates its business and the nature of those operations. Depending on the facts and circumstances Intevac determines the fair value of each of its reporting units based upon the most appropriate valuation technique using the income approach, the market approach or a combination thereof. The income and market approaches were selected as management believes these approaches generally provide the most reliable indications of fair value when the value of the operations is more dependent on the ability to generate earnings than on the value of the assets used in the production process. Under the income approach Intevac calculates the fair value of the reporting units based on the present value of estimated future cash flows. Under the market approach Intevac estimates the fair value based on market multiples of revenue or earnings for comparable companies. Each valuation technique has advantages and drawbacks, which must be considered when applying those techniques. The income approach closely correlates to management s expectations of future results but

requires significant assumptions which can be highly sensitive. The market approach is relatively straightforward to measure, but it may be difficult to find directly comparable companies in the marketplace. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then Intevac would perform the second step of the impairment test in order to determine the implied fair value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, Intevac would record an impairment loss equal to the difference.

***Equity-Based Compensation***

Intevac records compensation expense for equity-based awards using the Black-Scholes option pricing model. This model requires Intevac to estimate the expected volatility of the price of Intevac s common stock and the expected life of the equity-based awards. Intevac also estimates the forfeiture of the equity-based awards. Estimating volatility, expected life and forfeitures requires significant judgment and an analysis of historical data. Intevac may have to increase or decrease compensation expense for equity-based awards if actual results differ significantly from Intevac s estimates.

**Item 7A.** ***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, municipal bonds and VRDNs.

The table below presents principal amounts and related weighted-average interest rates by year of expected maturity for Intevac s investment portfolio at December 31, 2012.

| | 2013 | 2014 | 2015 | 2016 | 2017 | Total | Fair Value |
|---|---|---|---|---|---|---|---|
| Cash equivalents | | | | | | | |
| Variable rate amounts | $ 18,322 | | | | | $ 18,322 | $ 18,322 |
| Weighted-average rate | 0.10% | | | | | | |
| Short-term investments | | | | | | | |
| Fixed rate amounts | $ 38,183 | | | | | $ 38,183 | $ 38,218 |
| Weighted-average rate | 1.89% | | | | | | |
| Variable rate amounts | $ 2,375 | | | | | $ 2,375 | $ 2,373 |
| Weighted-average rate | 1.64% | | | | | | |
| Long-term investments | | | | | | | |
| Fixed rate amounts | | $ 27,275 | | | | $ 27,275 | $ 27,317 |
| Weighted-average rate | | 2.09% | | | | | |
| Total investment portfolio | $ 58,880 | $ 27,275 | | | | $ 86,155 | $ 86,230 |

*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. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on Intevac s operating results. The notional amount of Company s foreign currency derivatives was $491,000 at December 31, 2012. Intevac had no foreign currency forward exchange contracts during any of the years ended December 31, 2011 and 2010.

**Item 8.** ***Financial Statements and Supplementary Data***

**INTEVAC, INC.**

**CONSOLIDATED FINANCIAL STATEMENTS**

**Contents**

**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

Board of Directors and Stockholders

Intevac, Inc.

We have audited the accompanying consolidated balance sheets of Intevac, Inc. (a Delaware corporation) and subsidiaries (the Company ) as of December 31, 2012 and 2011, and the related consolidated statements of operations, comprehensive income (loss), stockholders equity, and cash flows for each of the three years in the period ended December 31, 2012. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Intevac, Inc. and subsidiaries as of December 31, 2012 and 2011 and the results of their operations and their cash flows for each of the three years in the period ended December 31, 2012 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2012, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated February 22, 2013 expressed an unqualified opinion on the effectiveness of the Company s internal control over financial reporting.

/s/ GRANT THORNTON LLP

San Jose, California

February 22, 2013

**INTEVAC, INC.**

**CONSOLIDATED BALANCE SHEETS**

| | December 31, 2012 | 2011 |
|---|---|---|
| | (In thousands, except par value) | |
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 24,261 | $ 23,560 |
| Short-term investments | 40,591 | 58,585 |
| Trade, notes and other accounts receivable, net of allowances of $0 and $41 at December 31, 2012 and 2011, respectively .. | 19,822 | 18,561 |
| Inventories | 26,193 | 18,070 |
| Prepaid expenses and other current assets | 2,120 | 7,114 |
| Deferred income tax assets | | 2,202 |
| Total current assets | 112,987 | 128,092 |
| Property, plant and equipment, net | 13,426 | 14,449 |
| Long-term investments | 27,317 | 32,677 |
| Goodwill | | 18,389 |
| Other intangible assets, net of amortization of $2,887 and $2,344 at December 31, 2012 and 2011, respectively | 5,868 | 6,441 |
| Deferred income taxes and other long-term assets | 12,905 | 25,773 |
| Total assets | $ 172,503 | $ 225,821 |
| **LIABILITIES AND STOCKHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 4,479 | $ 4,857 |
| Accrued payroll and related liabilities | 4,194 | 4,205 |
| Other accrued liabilities | 8,489 | 9,887 |
| Customer advances | 2,193 | 5,040 |
| Deferred income taxes | 1,281 | |
| Total current liabilities | 20,636 | 23,989 |
| Other long-term liabilities | 9,232 | 9,922 |
| Commitments and contingencies | | |
| Stockholders equity: | | |
| Undesignated preferred stock, $0.001 par value, 10,000 shares authorized, no shares issued and outstanding | | |
| Common stock, $0.001 par value : | | |
| Authorized shares 50,000 issued and outstanding shares 23,466 and 23,122 at December 31, 2012 and 2011, respectively | 23 | 23 |
| Additional paid-in-capital | 151,996 | 146,307 |
| Accumulated other comprehensive income | 769 | 414 |
| Retained earnings (accumulated deficit) | (10,153) | 45,166 |
| Total stockholders equity | 142,635 | 191,910 |
| Total liabilities and stockholders equity | $ 172,503 | $ 225,821 |

See accompanying notes.

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**INTEVAC, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands, except per share amounts) | | |
| Net revenues: | | | |
| Systems and components | $ 67,669 | $ 75,850 | $ 184,217 |
| Technology development | 15,755 | 7,124 | 18,309 |
| Total net revenues | 83,424 | 82,974 | 202,526 |
| Cost of net revenues: | | | |
| Systems and components | 37,932 | 47,601 | 101,975 |
| Technology development | 11,334 | 4,942 | 12,879 |
| Total cost of net revenues | 49,266 | 52,543 | 114,854 |
| Gross profit | 34,158 | 30,431 | 87,672 |
| Operating expenses: | | | |
| Research and development | 31,762 | 34,287 | 27,918 |
| Selling, general and administrative | 25,700 | 26,844 | 28,516 |
| Bad debt expense | 3,017 | 41 | |
| Impairment of goodwill and intangible assets | 18,419 | | |
| Total operating expenses | 78,898 | 61,172 | 56,434 |
| Gain on sale of mainframe technology | 2,207 | | |
| Operating income (loss) | (42,533) | (30,741) | 31,238 |
| Interest income | 806 | 847 | 899 |
| Other income (expense), net | (352) | (212) | (126) |
| Income (loss) before income taxes | (42,079) | (30,106) | 32,011 |
| Provision (benefit) for income taxes | 13,240 | (8,131) | 3,962 |
| Net income (loss) | $ (55,319) | $ (21,975) | $ 28,049 |
| Net income (loss) per share: | | | |
| Basic | $ (2.37) | $ (0.96) | $ 1.26 |
| Diluted | $ (2.37) | $ (0.96) | $ 1.22 |
| Weighted average shares outstanding: | | | |
| Basic | 23,336 | 22,903 | 22,340 |
| Diluted | 23,336 | 22,903 | 22,977 |

See accompanying notes.

**INTEVAC, INC.**

**CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| | (In thousands) | | |
| Net income (loss) | $ (55,319) | $ (21,975) | $ 28,049 |
| Other comprehensive income, before tax | | | |
| Change in unrealized net loss on available-for-sale investments | 486 | 217 | 3,072 |
| Foreign currency translation gains | 13 | 18 | 86 |
| | 499 | 235 | 3,158 |
| Income tax expense related to items in other comprehensive income | (144) | (76) | (1,075) |
| Other comprehensive income, net of tax | 355 | 159 | 2,083 |
| Comprehensive income (loss) | $ (54,964) | $ (21,816) | $ 30,132 |

See accompanying notes.

**INTEVAC, INC.**

**CONSOLIDATED STATEMENT OF STOCKHOLDERS EQUITY**

**(In thousands)**

| | Common Stock | | Additional Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Retained Earnings (Accumulated Deficit) | Total Stockholders Equity |
|---|---|---|---|---|---|---|
| | Shares | Amount | | | | |
| Balance at December 31, 2009 | 22,079 | $ 22 | $ 134,071 | $ (1,828) | $ 39,092 | $ 171,357 |
| Shares issued in connection with: | | | | | | |
| Exercise of stock options | 224 | 1 | 1,740 | | | 1,741 |
| Employee stock purchase plan | 255 | | 1,027 | | | 1,027 |
| Net income tax detriment from activity in employee stock plans | | | (279) | | | (279) |
| Equity-based compensation | | | 3,265 | | | 3,265 |
| Net income | | | | | 28,049 | 28,049 |
| Other comprehensive income | | | | 2,083 | | 2,083 |
| Balance at December 31, 2010 | 22,558 | $ 23 | $ 139,824 | $ 255 | $ 67,141 | $ 207,243 |
| Shares issued in connection with: | | | | | | |
| Exercise of stock options | 330 | | 1,539 | | | 1,539 |
| Employee stock purchase plan | 234 | | 1,385 | | | 1,385 |
| Net income tax detriment from activity in employee stock plans | | | (471) | | | (471) |
| Equity-based compensation | | | 4,030 | | | 4,030 |
| Net loss | | | | | (21,975) | (21,975) |
| Other comprehensive income | | | | 159 | | 159 |
| Balance at December 31, 2011 | 23,122 | $ 23 | $ 146,307 | $ 414 | $ 45,166 | $ 191,910 |
| Shares issued in connection with: | | | | | | |
| Exercise of stock options | 43 | | 143 | | | 143 |
| Employee stock purchase plan | 301 | | 1,726 | | | 1,726 |
| Equity-based compensation | | | 3,820 | | | 3,820 |
| Net loss | | | | | (55,319) | (55,319) |
| Other comprehensive income | | | | 355 | | 355 |
| Balance at December 31, 2012 | 23,466 | $ 23 | $ 151,996 | $ 769 | $ (10,153) | $ 142,635 |

See accompanying notes.

**INTEVAC, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Years Ended December 31, | | |
|---|---|---|---|
| | **2012** | **2011** | **2010** |
| **Operating activities** | | | |
| Net income (loss) | $ (55,319) | $ (21,975) | $ 28,049 |
| Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by (used in) operating activities: | | | |
| Depreciation & amortization | 3,936 | 4,880 | 5,307 |
| Net amortization (accretion) of investment premiums and discounts | 1,316 | 1,408 | |
| Net loss on sale of investments | 363 | 308 | |
| Gain on acquisition | | | (481) |
| Impairment of goodwill and intangible assets | 18,419 | | |
| Amortization of intangible assets | 543 | 543 | 554 |
| Bad debt expense | 3,017 | 41 | |
| Equity-based compensation | 3,820 | 4,030 | 3,316 |
| Deferred income taxes | (10,099) | (7,140) | (2,142) |
| Deferred income taxes valuation allowance | 23,437 | | |
| Excess tax benefits from equity-based compensation | | | (299) |
| Gain on sale of mainframe technology | (2,207) | | |
| Change in the fair value of acquisition-related contingent consideration | (219) | 1,247 | 108 |
| Loss (gain) on disposal of equipment | 190 | (78) | 153 |
| Changes in assets and liabilities: | | | |
| Accounts receivable | (3,531) | 7,309 | 18,845 |
| Inventories | (8,738) | 2,601 | (1,555) |
| Prepaid expenses and other assets | 6,089 | 87 | (2,665) |
| Accounts payable | (378) | (705) | 450 |
| Accrued payroll and other accrued liabilities | 2,492 | (9,008) | 9,987 |
| Customer advances | (2,847) | 173 | (8,313) |
| Total adjustments | 35,603 | 5,696 | 23,265 |
| Net cash and cash equivalents provided by (used in) operating activities | (19,716) | (16,279) | 51,314 |
| **Investing activities** | | | |
| Purchase of investments | (47,199) | (111,940) | (20,683) |
| Proceeds from sales and maturities of investments | 69,360 | 47,039 | 68,050 |
| Acquisition of SIT, net of cash acquired | | | (2,638) |
| Proceeds from sale of mainframe technology | 3,000 | | |
| Proceeds from sale of equipment | | 249 | |
| Purchase of equipment | (3,280) | (5,582) | (7,055) |
| Net cash and cash equivalents provided by (used in) investing activities | 21,881 | (70,234) | 37,674 |
| **Financing activities** | | | |
| Proceeds from issuance of common stock | 1,869 | 2,924 | 2,768 |
| Payment of acquisition-related contingent consideration | (3,345) | (2,389) | |
| Payment of notes payable assumed upon SIT acquisition | | | (177) |
| Excess tax benefits from equity-based compensation | | | 299 |
| Net cash and cash equivalents provided by (used in) financing activities | (1,476) | 535 | 2,890 |
| Effect of exchange rate changes on cash | 12 | 18 | 50 |
| Net increase (decrease) in cash and cash equivalents | 701 | (85,960) | 91,928 |

| | | | |
|---|---|---|---|
| Cash and cash equivalents at beginning of period | 23,560 | 109,520 | 17,592 |
| Cash and cash equivalents at end of period | $ 24,261 | $ 23,560 | $ 109,520 |
| Cash paid (received) for: | | | |
| Income taxes | $ 24 | $ 336 | $ 1,829 |
| Income tax refund | $ (4,608) | $ (683) | $ (481) |

See accompanying notes.

**INTEVAC, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Summary of Significant Accounting Policies**

***Principles of Consolidation and Basis of Presentation***

The consolidated financial statements include the accounts of Intevac, Inc. and its subsidiaries (Intevac or the Company) after elimination of inter-company balances and transactions.

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

***Cash, Cash Equivalents and Investments***

Intevac considers all highly liquid investments with original maturities of three months or less when purchased to be cash equivalents. Available-for-sale securities, comprised of commercial paper, obligations of the U.S. government and its agencies, corporate debt securities, municipal bonds, VRDNs and ARS, are carried at fair value, with unrealized gains and losses recorded within other comprehensive income (loss) as a separate component of stockholders equity. Realized gains and losses and declines in value judged to be other than temporary, if any, on available-for-sale securities are included in earnings. The cost of investment securities sold is determined by the specific identification method.

***Fair Value Measurement Definition and Hierarchy***

Intevac reports certain financial assets and liabilities at fair value. Intevac defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair value measurements are classified and disclosed in one of the following three categories:

*Level 1* Valuations based on quoted prices in active markets for identical assets or liabilities.

*Level 2* Valuations based on other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

*Level 3* Valuations based on inputs that are generally unobservable and typically reflect management s estimates of assumptions that market participants would use in pricing the asset or liability.

***Business Combinations***

Intevac accounts for business combinations using the acquisition method of accounting. Transaction costs are expensed as incurred. IPR&D costs are capitalized as an intangible asset. Contingent consideration is recorded as a liability at the measurement date with subsequent re-measurements recorded as general and administrative expense. Costs for business restructuring and exit activities related to the acquired company are included in the post-combination financial results. During 2010, Intevac incurred $255,000 of acquisition-related costs which have been included in selling, general and administrative expenses on the consolidated statements of operations.

***Trade Accounts and Notes Receivables and Doubtful Accounts***

Intevac evaluates the collectibility of trade accounts receivables and notes receivable on an ongoing basis and provides reserves against potential losses when appropriate. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, changes in customer payment tendencies and current

**INTEVAC, INC.**

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

economic trends when evaluating the adequacy of the allowance for doubtful accounts. Customer accounts are written off against the allowance when the amount is deemed uncollectible. Also, accounts determined to be uncollectible are put in nonaccrual status whereby interest is not accrued on those accounts.

***Inventories***

Inventories are generally stated at the lower of cost or market, with cost determined on an average cost basis.

***Property, Plant and Equipment***

Equipment and leasehold improvements are stated at cost. Depreciation is computed using the straight-line method over the estimated useful lives of the assets as follows: computers and software, 3 years; machinery and equipment, 5 years; furniture, 7 years; vehicles, 4 years; and leasehold improvements, remaining lease term.

***Goodwill and Purchased Intangible Assets***

The purchase price of an acquired business is allocated, as applicable, between IPR&D, other identifiable intangible assets, net tangible assets and goodwill. IPR&D is defined as the value assigned to those projects for which the related products have no alternative future use. Determining the portion of the purchase price allocated to IPR&D and other intangible assets requires the Company to make significant estimates. The amount of the purchase price allocated to IPR&D and other intangible assets is determined by estimating the future cash flows of each project or technology and discounting the net cash flows back to their present values. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. For IPR&D, these valuation methodologies include consideration of the risk of the project not achieving commercial feasibility. The IPR&D will be subject to amortization upon commercialization. If the technology is abandoned, the IPR&D will be written-off.

Contingent consideration is recorded at the acquisition date at the estimated fair value of the contingent payments. The acquisition date fair value is measured based on the consideration expected to be transferred (probability-weighted), discounted back to present value. The discount rate used is determined at the time of the acquisition in accordance with accepted valuation methods. The fair value of the contingent consideration is remeasured at the estimated fair value at each reporting period with the change in fair value recognized as income or expense in the consolidated statements of operations.

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

Purchased intangible assets other than goodwill are amortized over their useful lives unless these lives are determined to be indefinite. Purchased intangible assets are carried at cost, less accumulated amortization. Amortization is computed over the estimated useful lives of the respective assets, generally one to thirteen years using the straight line method.

Goodwill and purchased intangible assets with indefinite useful lives are not amortized, but are reviewed for impairment annually during the fourth quarter of each fiscal year and whenever events or changes in circumstances indicate that the carrying value of an asset may not be recoverable. For goodwill, Intevac performs a two-step impairment test. In the first step, Intevac compares the fair value of each reporting unit to its carrying value. Intevac s reporting units are consistent with the reportable segments identified in Note 13, based on the

**INTEVAC, INC.**

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

manner in which Intevac operates its business and the nature of those operations. Depending on the facts and circumstances Intevac determines the fair value of each of its reporting units based upon the most appropriate valuation technique using the income approach, the market approach or a combination thereof. The income and market approaches were selected as management believes these approaches generally provide the most reliable indications of fair value when the value of the operations is more dependent on the ability to generate earnings than on the value of the assets used in the production process. Under the income approach Intevac calculates the fair value of the reporting units based on the present value of estimated future cash flows. Under the market approach Intevac estimates the fair value based on market multiples of revenue or earnings for comparable companies. Each valuation technique has advantages and drawbacks, which must be considered when applying those techniques. The income approach closely correlates to management s expectations of future results but requires significant assumptions which can be highly sensitive. The market approach is relatively straightforward to measure, but it may be difficult to find directly comparable companies in the marketplace. If the fair value of the reporting unit exceeds the carrying value of the net assets assigned to that unit, goodwill is not impaired and no further testing is performed. If the carrying value of the net assets assigned to the reporting unit exceeds the fair value of the reporting unit, then Intevac would perform the second step of the impairment test in order to determine the implied fair value of the reporting unit s goodwill. If the carrying value of a reporting unit s goodwill exceeds its implied fair value, Intevac would record an impairment loss equal to the difference.

***Impairment of Long-Lived Assets***

Long-lived assets and certain identifiable finite-lived intangible assets to be held and used are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Determination of recoverability of long-lived assets is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. Measurement of an impairment loss for long-lived assets and certain identifiable intangible assets that management expects to hold and use is based on the fair value of the asset. When an impairment loss is recognized, the carrying amount of the asset is reduced to its estimated fair value. No impairment charges were recognized in fiscal 2012, 2011 and 2010.

***Income Taxes***

Deferred tax assets and liabilities are recognized using enacted tax rates for the effect of temporary differences between book and tax bases of recorded assets and liabilities. Deferred tax assets are reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized.

On a quarterly basis, Intevac provides for income taxes based upon an annual effective income tax rate. The effective tax rate is highly dependent upon 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. Intevac carefully monitors the changes in many factors and adjust its effective income tax rate on a timely basis. If actual results differ from the estimates, this could have a material effect on Intevac s business, financial condition and results of operations.

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

Intevac recognizes accrued interest and penalties related to unrecognized tax benefits in the provision for income taxes.

***Sales and Value Added Taxes***

Taxes collected from customers and remitted to governmental authorities are presented on a net basis in the accompanying consolidated statements of operations.

**INTEVAC, INC.**

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

***Revenue Recognition***

Intevac recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred and title and risk of loss have passed to Intevac s customer or services have been rendered, the price is fixed or determinable, and collectibility is reasonably assured. Intevac s shipping terms are customarily FOB shipping point or equivalent terms. Intevac s revenue recognition policy generally results in revenue recognition at the following points: (1) for all transactions where legal title passes to the customer upon shipment, Intevac recognizes revenue upon shipment for all products that have been demonstrated to meet product specifications prior to shipment; the portion of revenue associated with certain installation-related tasks is deferred, and that revenue is recognized upon completion of the installation-related tasks; (2) for products that have not been demonstrated to meet product specifications prior to shipment, revenue is recognized at customer acceptance; and (3) for arrangements containing multiple elements, the revenue relating to the undelivered elements is deferred until delivery of the deferred elements. When a sales arrangement contains multiple elements, Intevac allocates revenue to each element based on a selling price hierarchy. The selling price for a deliverable is based on its VSOE if available, TPE if VSOE is not available, or best ESP if neither VSOE nor TPE is available. Intevac generally utilizes the ESP due to the nature of its products. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements, usually split between delivery of the parts and installation on the customer s systems. In these cases, Intevac recognizes revenue for the relative sales price of the parts upon shipment and transfer of title, and recognizes revenue for the relative sales price of installation services when those services are completed. Revenue related to sales of spare parts is generally recognized upon shipment. Revenue related to services is generally recognized upon completion of the services. In addition, Intevac uses the installment method to record revenue based on cash receipts in situations where the account receivable is collected over an extended period of time and in management s judgment the degree of collectibility is uncertain.

Intevac performs research and development work under various government-sponsored research contracts. Revenue on cost-plus-fee contracts is recognized to the extent of costs actually incurred plus a proportionate amount of the fee earned. Intevac considers fixed fees under cost-plus-fee contracts to be earned in proportion to the allowable costs actually incurred in performance of the contract. Revenue on fixed-price contracts is recognized on a milestone method or percentage-of-completion method of contract accounting. For contracts structured as milestone agreements, revenue is recognized when a specified milestone is achieved, provided that (1) the milestone event is substantive in nature and there is substantial uncertainty about the achievement of the milestone at the inception of the agreement, (2) the milestone payment is non-refundable, and (3) there is no continuing performance obligations associated with the milestone payment. Any milestone payments received prior to satisfying these revenue recognition criteria are deferred. Intevac generally determines the percentage completed based on the percentage of costs incurred to date in relation to total estimated costs expected through completion of the contract. When estimates of total costs to be incurred on a contract exceed estimates of total revenue to be earned, a provision for the entire loss on the contract is recorded in the period the loss is determined.

***Advertising Costs***

Advertising costs are expensed as incurred. Advertising costs were not material for all periods presented.

***Foreign Currency Translation***

The functional currency of Intevac s foreign subsidiaries in Singapore and Hong Kong and the Taiwan branch is the U.S. dollar. The functional currency of Intevac s foreign subsidiaries in China, Malaysia and Korea is the local currency of the country in which the respective subsidiary operates. Assets and liabilities recorded in foreign currencies are translated at year-end exchange rates; revenues and expenses are translated at average exchange rates during the year. The effect of foreign currency translation adjustments are included in stockholders equity as a component of accumulated other comprehensive income in the accompanying

**INTEVAC, INC.**

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

consolidated balance sheets. The effects of foreign currency transactions are included in other income in the determination of net income. Net losses from foreign currency transactions were $78,000, $32,000 and $520,000 in 2012, 2011 and 2010, respectively.

***Comprehensive Income***

The components of accumulated other comprehensive income (loss), were as follows at December 31, 2012 and 2011:

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (In thousands) | |
| Accumulated net unrealized holding gain (loss) on available-for-sale investments | $ 75 | $ (411) |
| Income tax benefit | | 144 |
| | 75 | (267) |
| Foreign currency translation gains | 694 | 681 |
| Total accumulated other comprehensive income | $ 769 | $ 414 |

***Employee Stock Plans***

Intevac has equity-based compensation plans that provide for the grant to employees of equity-based awards, including incentive or non-statutory stock options, restricted stock, stock appreciation rights, restricted stock units ( RSUs also referred to as performance units) and performance shares. In addition, these plans provide for the grant of non-statutory stock options and RSUs to non-employee directors and consultants. Intevac also has an employee stock purchase plan, which provides Intevac s employees with the opportunity to purchase Intevac common stock at a discount through payroll deductions. See Note 2 for a complete description of these plans and their accounting treatment.

**Recent Accounting Pronouncement**

In July 2012, the FASB amended its existing guidance for goodwill and other intangible assets. This authoritative guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. To perform a qualitative assessment, a company must identify and evaluate changes in economic, industry and company-specific events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. If a company determines that it is more likely than not that the fair value of such an asset exceeds its carrying amount, it would not need to calculate the fair value of the asset in that year. This authoritative guidance becomes effective for Intevac in the first quarter of fiscal 2013. The implementation of this authoritative guidance is not expected to have a material impact on Intevac s financial position or results of operations.

**2. Equity-Based Compensation**

Intevac accounts for share-based awards in accordance with the provisions of the accounting guidance which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees, consultants and directors based upon the grant-date fair value of those awards. The estimated fair value of Intevac s equity-based awards, less expected forfeitures, is amortized over the awards service periods using the graded vesting attribution method.

**INTEVAC, INC.**

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

**Descriptions of Plans**

*Equity Incentive Plans*

At December 31, 2012, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan, the 2004 Equity Incentive Plan and the 1995 Equity Incentive Plan (the Plans ) and the 2003 Employee Stock Purchase Plan (the ESPP ). Intevac s stockholders approved all of these plans.

The Plans are a broad-based, long-term retention program intended to attract and retain qualified management and employees, and align stockholder and employee interests. The Plans permit the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, RSUs and performance shares. Option price, vesting period, and other terms are determined by the administrator of the Plans, but the option price shall generally not be less than 100% of the fair market value per share on the date of grant. As of December 31, 2012, 4.5 million shares of common stock were authorized for future issuance under the Plans. The 2012 Plan expires no later than May 8, 2022.

*2003 Employee Stock Purchase Plan*

In 2003, Intevac s stockholders approved adoption of the ESPP, which serves as the successor to the Employee Stock Purchase Plan originally adopted in 1995. Upon adoption of the ESPP, all shares available for issuance under the prior plan were transferred to the ESPP. The ESPP provides that eligible employees may purchase Intevac common stock through payroll deductions at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase interval. Offering periods are generally two years in length, and consist of a series of six-month purchase intervals. Eligible employees may join the ESPP at the beginning of any six-month purchase interval. Under the terms of the ESPP, employees can choose to have up to 15% of their base earnings withheld to purchase Intevac common stock. As of December 31, 2012, 301,000 shares remained available for issuance under the ESPP.

The effect of recording equity-based compensation for the years ended December 31, 2012, 2011 and 2010 was as follows (in thousands):

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Equity-based compensation by type of award: | | | |
| Stock options | $ 2,302 | $ 2,924 | $ 2,965 |
| RSUs | 201 | | |
| Employee stock purchase plan | 1,317 | 1,106 | 351 |
| Total equity-based compensation | 3,820 | 4,030 | 3,316 |
| Tax effect on equity-based compensation | (870) | (1,030) | (1,068) |
| Net effect on net income (loss) | $ 2,950 | $ 3,000 | $ 2,248 |

**INTEVAC, INC.**

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

***Stock Options***

The exercise price of each stock option equals the market price of Intevac s stock on the date of grant. Most options are scheduled to vest over four years and expire no later than ten years after the grant date. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. This model was developed for use in estimating the value of publicly traded options that have no vesting restrictions and are fully transferable. Intevac s employee stock options have characteristics significantly different from those of publicly traded options. The weighted average assumptions used in the model are outlined in the following table:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Stock Options: | | | |
| Weighed-average fair value of grants per share | $ 3.82 | $ 5.98 | $ 6.63 |
| Expected volatility | 63.56% | 64.82% | 67.75% |
| Risk free interest rate | 0.73% | 1.71% | 1.69% |
| Expected term of options (in years) | 4.60 | 4.75 | 4.52 |
| Dividend yield | None | None | None |

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

A summary of the stock option activity is as follows:

| | Shares | Weighted Average Exercise Price | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Options outstanding at December 31, 2011 | 3,391,925 | $ 12.03 | 5.53 | $ 1,384,535 |
| Options granted | 404,005 | $ 7.54 | | |
| Options forfeited | (624,985) | $ 12.27 | | |
| Options exercised | (42,537) | $ 3.36 | | |
| Options outstanding at December 31, 2012 | 3,128,408 | $ 11.52 | 4.08 | $ 181,019 |
| Vested and expected to vest at December 31, 2012 | 3,023,791 | $ 11.59 | 4.02 | $ 180,312 |
| Options exercisable at December 31, 2012 | 2,318,070 | $ 12.26 | 3.53 | $ 146,497 |

The total intrinsic value of options exercised during fiscal years 2012, 2011 and 2010 was $194,000, $1.9 million and $1.3 million, respectively. At December 31, 2012, Intevac had $1.9 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock option plans that will be recognized over the weighted average period of 1.29 years.

**INTEVAC, INC.**

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

The options outstanding and currently exercisable at December 31, 2012 were in the following exercise price ranges:

| | Options Outstanding | | | Options Exercisable | |
|---|---|---|---|---|---|
| Range of Exercise Prices | Number of Shares Outstanding | Weighted Average Remaining Contractual Term (In Years) | Weighted Average Exercise Price | Number Vested and Exercisable | Weighted Average Exercise Price |
| $3.91 - $ 9.99 | 997,884 | 4.43 | $ 6.55 | 580,388 | $ 6.09 |
| $10.00 - $19.99 | 1,904,524 | 3.92 | $ 12.85 | 1,511,682 | $ 13.16 |
| $20.00 - $29.45 | 226,000 | 3.83 | $ 22.15 | 226,000 | $ 22.15 |
| $3.91 - $29.45 | 3,128,408 | 4.08 | $ 11.52 | 2,318,070 | $ 12.26 |

***RSUs***

A summary of the RSU activity is as follows:

| | Shares | Weighted Average Grant Date Fair Value | Weighted Average Remaining Contractual Term (years) | Aggregate Intrinsic Value |
|---|---|---|---|---|
| Non-vested RSUs at December 31, 2011 | | $ | | $ |
| Granted | 110,001 | $ 7.35 | | |
| Vested | | $ | | |
| Cancelled | (9,540) | $ 7.55 | | |
| Non-vested RSUs at December 31, 2012 | 100,461 | $ 7.33 | 1.86 | $ 459,107 |
| RSUs expected to vest at December 31, 2012 | 82,219 | $ 7.33 | 1.73 | $ 375,740 |

RSUs are converted into shares of Intevac common stock upon vesting on a one-for-one basis. RSUs typically are scheduled to vest over four years. Vesting of 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. At December 31, 2012, Intevac had $422,000 of total unrecognized compensation expense, net of estimated forfeitures, related to RSUs that will be recognized over the weighted average period of 2.04 years.

***ESPP***

The fair value of the employee stock purchase right is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Stock Purchase Rights: | | | |
| Weighed-average fair value of grants per share | $ 3.01 | $ 4.84 | $ 4.63 |
| Expected volatility | 62.36% | 51.63% | 55.20% |
| Risk free interest rate | 0.28% | 0.44% | 0.41% |

| | | | |
|---|---|---|---|
| Expected term of purchase rights (in years) | 1.68 | 1.36 | 0.73 |
| Dividend yield | None | None | None |

The expected life of purchase rights is the period of time remaining in the current offering period.

**INTEVAC, INC.**

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

The ESPP activity during the years ended December 31, 2012, 2011 and 2010 is as follows:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| | (In thousands, except per share amounts) | | |
| Shares purchased | 301 | 234 | 255 |
| Weighted average purchase price per share | $ 5.73 | $ 5.92 | $ 4.02 |
| Aggregate intrinsic value of purchase rights exercised | $ 304 | $ 1,361 | $ 2,180 |

As of December 31, 2012, Intevac had $957,000 of total unrecognized compensation expense, net of estimated forfeitures related to purchase rights that will be recognized over the weighted average period of 0.7 years.

**3. Earnings Per Share**

Intevac calculates basic earnings per share ( EPS ) using net income (loss) and the weighted-average number of shares outstanding during the reporting period. Diluted EPS includes the effect from potential issuance of common stock pursuant to the exercise of employee stock options and vesting of RSUs.

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

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| | (In thousands, except per share amounts) | | |
| Net income (loss) | $ (55,319) | $ (21,975) | $ 28,049 |
| Weighted-average shares basic | 23,336 | 22,903 | 22,340 |
| Effect of dilutive potential common shares | | | 637 |
| Weighted-average shares diluted | 23,336 | 22,903 | 22,977 |
| Net income (loss) per share basic | $ (2.37) | $ (0.96) | $ 1.26 |
| Net income (loss) per share diluted | $ (2.37) | $ (0.96) | $ 1.22 |
| Antidilutive shares based on employee awards excluded | 3,008 | 2,699 | 1,896 |

Potentially dilutive common shares consist of shares issuable upon exercise of employee stock options and vesting of RSUs and are excluded from the calculation of diluted EPS when their effect would be anti-dilutive.

**4. Concentrations**

***Credit Risk and Significant Customers***

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist of cash equivalents, short- and long-term investments, and accounts and notes receivable. Intevac generally invests its excess cash in money market funds, commercial paper, obligations of the U.S. government and its agencies, corporate debt securities, municipal bonds and VRDNs. 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.

Intevac s accounts receivable tend to be concentrated in a limited number of customers. The following customers accounted for at least 10 percent of Intevac s accounts receivable at December 31, 2012 and 2011.

| | 2012 | 2011 |
|---|---|---|
| U.S. Government | 29% | * |
| Seagate Technology | 24% | 37% |

* Less than 10%

**INTEVAC, INC.**

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

Intevac s largest customers tend to change from period to period. Historically, a significant portion of Intevac s revenues in any particular period have been attributable to sales to a limited number of customers. Intevac performs credit evaluations of its customers financial condition and generally requires deposits on system orders but does not generally require collateral or other security to support customer receivables.

The following customers accounted for at least 10 percent of Intevac s consolidated net revenues in 2012, 2011, and/or 2010.

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| Seagate Technology | 51% | 41% | 40% |
| U.S. Government | 10% | * | * |
| HGST | * | 12% | 26% |
| Fuji Electric | * | * | 12% |

* Less than 10%

***Products***

Disk manufacturing products contributed a significant portion of Intevac s revenues in 2012, 2011, and 2010. Intevac expects that the ability to maintain or expand its current levels of revenues in the future will depend upon continuing market demand for its products; its success in enhancing its existing systems and developing and manufacturing competitive disk manufacturing equipment, such as the 200 Lean; Intevac s success in developing both military and commercial products based on its low-light technology; and its success in utilizing Intevac s expertise in complex manufacturing equipment to develop and sell new equipment products for PV manufacturing.

**5. Balance Sheet Details**

Balance sheet details were as follows as of December 31, 2012 and 2011:

***Trade, Notes and Other Accounts receivable, Net***

Receivables consisted of the following components:

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (in thousands) | |
| Trade receivables and other | $ 14,877 | $ 16,057 |
| Unbilled costs and accrued profits | 4,945 | 996 |
| Current portion of promissory note receivable | | 1,549 |
| Less: allowance for doubtful accounts | | (41) |
| | $ 19,822 | $ 18,561 |

Included in trade receivables at December 31, 2011 is the current portion of a discounted promissory note from a customer. The non-current portion of the note receivable of $3.0 million was included in other long-term assets.

**INTEVAC, INC.**

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

***Allowance for Doubtful Accounts***

The following table represents a reconciliation of the allowance for doubtful accounts for the years ended December 31, 2012, 2011 and 2010:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| | | (in thousands) | |
| Opening balance | $ 41 | $ 55 | $ 133 |
| Bad debt expense | 3,017 | 41 | |
| Write-offs | (3,058) | (55) | (78) |
| Closing balance | $ | $ 41 | $ 55 |

Intevac held a promissory note from a customer which was secured by the equipment sold to this customer in a prior year under a product and sales agreement. The note was to be repaid in monthly installment payments ending in March 2015. The revenue associated with this sale had been accounted for under the installment method of accounting whereby revenue was recognized only to the extent cash had been received. During the third quarter of fiscal 2012, the customer became delinquent in its monthly installment payments and the note was put on non-accrual status. On September 27, 2012, the customer liquidated its operating assets in an auction. The equipment which collateralized the promissory note was sold in the liquidation auction and Intevac received the proceeds. On September 28, 2012, the customer announced that it was discontinuing its operations effective October 9, 2012 and Intevac concluded that none of the carrying value of the promissory note receivable was collectible and recorded a bad debt charge.

The following table summarizes the components of the bad debt expense for the year ended December 31, 2012 (in thousands):

| | |
|---|---|
| Promissory note | $ 4,085 |
| Deferred profit on installment sale | (1,028) |
| Cash recovery from liquidation sale | (40) |
| Bad debt expense | $ 3,017 |

***Inventories***

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

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (in thousands) | |
| Raw materials | $ 14,921 | $ 12,662 |
| Work-in-progress | 5,526 | 3,020 |
| Finished goods | 5,746 | 2,388 |
| | $ 26,193 | $ 18,070 |

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

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

***Property, Plant and Equipment***

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (in thousands) | |
| Leasehold improvements | $ 15,254 | $ 14,936 |
| Machinery and equipment | 37,373 | 40,469 |
| | 52,627 | 55,405 |
| Less accumulated depreciation and amortization | 39,201 | 40,956 |
| Total property, plant and equipment, net | $ 13,426 | $ 14,449 |

***Customer Advances***

Customer advances generally represent nonrefundable deposits invoiced by the Company in connection with receiving customer purchase orders and other events preceding acceptance of systems. Customer advances related to products that have not been shipped to customers and included in accounts receivable were $1.6 million at December 31, 2012 and $1.9 million at December 31, 2011.

***Accounts Payable***

Included in accounts payable is $505,000 and $714,000 of book overdraft at December 31, 2012 and 2011, respectively.

***Other Accrued Liabilities***

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (in thousands) | |
| Deferred revenue | $ 4,641 | $ 1,665 |
| Accrued product warranties | 2,259 | 2,586 |
| Other taxes payable | 729 | 714 |
| Acquisition-related contingent consideration | 265 | 3,942 |
| Accrued income taxes | 207 | 183 |
| Other | 388 | 797 |
| Total other accrued liabilities | $ 8,489 | $ 9,887 |

***Other Long-Term Liabilities***

| | December 31, | |
|---|---|---|
| | 2012 | 2011 |
| | (in thousands) | |
| Acquisition-related contingent consideration | $ 4,886 | $ 4,773 |
| Accrued income taxes | 4,256 | 4,191 |
| Deferred profit | | 820 |

| | | |
|---|---|---|
| Accrued product warranties | 90 | 138 |
| Total other long-term liabilities | $ 9,232 | $ 9,922 |

**6. Goodwill and Purchased Intangible Assets, Net**

Goodwill and indefinite life intangible assets are tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill and indefinite life intangible assets may be impaired.

**INTEVAC, INC.**

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

Intevac performed its annual goodwill impairment test in the fourth quarter of fiscal 2012, and, based on step one of the impairment analysis, Intevac determined that the fair values of both its Equipment and Intevac Photonics reporting units were less than their carrying value and potential impairment existed. Intevac completed the second step of the goodwill impairment analysis and determined that there would be no remaining implied value attributable to goodwill in either reporting unit and accordingly, Intevac wrote off all of the goodwill in both its Equipment and Intevac Photonics reporting units. In the second half of 2012, the Company experienced a significant decline in its stock price which resulted in the Company s market capitalization falling significantly below the recorded value of its consolidated net assets.

Intevac also performed its annual impairment tests on its indefinite life intangible assets in the fourth quarter of fiscal 2012, and, based on the impairment analysis, Intevac determined that the indefinite life tradename was impaired and recorded an immaterial impairment charge. The IPR&D was not impaired.

Intevac conducted its annual impairment tests in the fourth quarter of fiscal 2011 and 2010 and the results of these tests indicated that Intevac s goodwill and purchased intangible assets with indefinite useful lives were not impaired.

Information regarding goodwill by reportable segment for the years ended December 31, 2012 and 2011 is as follows:

| | December 31, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Equipment | Intevac Photonics | Total | Equipment | Intevac Photonics | Total |
| | | | (in thousands) | | | |
| Beginning balance | $ 10,484 | $ 7,905 | $ 18,389 | $ 10,484 | $ 7,905 | $ 18,389 |
| Impairment charges | (10,484) | (7,905) | (18,389) | | | |
| Ending balance | $ | $ | $ | $ 10,484 | $ 7,905 | $ 18,389 |

Information regarding other acquisition-related intangible assets is as follows:

| | December 31, 2012 | | | December 31, 2011 | | |
|---|---|---|---|---|---|---|
| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount | Gross Carrying Amount | Accumulated Amortization | Net Carrying Amount |
| | | | (in thousands) | | | |
| Customer relationships | $ 3,181 | $ 1,869 | $ 1,312 | $ 3,181 | $ 1,472 | $ 1,709 |
| Purchased technology | 1,145 | 679 | 466 | 1,145 | 533 | 612 |
| Covenants not to compete | 140 | 140 | | 140 | 140 | |
| Backlog | 199 | 199 | | 199 | 199 | |
| Total amortizable intangible assets | 4,665 | 2,887 | 1,778 | 4,665 | 2,344 | 2,321 |
| IPR&D | 4,000 | | 4,000 | 4,000 | | 4,000 |
| Tradename | 90 | | 90 | 120 | | 120 |
| Total intangible assets | $ 8,755 | $ 2,887 | $ 5,868 | $ 8,785 | $ 2,344 | $ 6,441 |

Intangible assets by segment as of December 31, 2012 are as follows: Equipment; $5.1 million and Intevac Photonics; $731,000.

Total amortization expense of purchased intangibles for the years ended December 31, 2012, 2011 and 2010 was $543,000, $543,000 and $554,000 respectively.

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**INTEVAC, INC.**

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

Estimated future amortization expense related to finite-lived purchased intangible assets as of December 31, 2012, is as follows.

| **(In thousands)** | |
|---|---|
| 2013 | 541 |
| 2014 | 363 |
| 2015 | 283 |
| 2016 | 281 |
| 2017 | 187 |
| Thereafter | 123 |
| | $ 1,778 |

**7. Business Combination**

On November 19, 2010, Intevac acquired the outstanding shares of SIT, a privately-owned, development stage company, which was focused on creating an ion implant module to be used in the manufacturing of photovoltaic cells. Intevac s primary reasons for this acquisition were to complement its existing product offerings and to provide opportunities for future growth. The preliminary aggregate purchase price was $12.4 million, which consisted of an initial cash payment totaling $2.7 million and a contingent consideration obligation with a fair value of $9.7 million payable in cash. In connection with the acquisition, Intevac acquired IPR&D, tangible assets, and goodwill and assumed tangible liabilities. Intevac also recorded a net deferred tax liability to reflect the tax impact of the identified intangible assets that will not generate tax deductible amortization expense net of the future tax benefit of acquired net operating loss carryforwards. The value attributable to IPR&D has been capitalized as an indefinite-lived intangible asset. Goodwill is attributable to estimated synergies arising from the acquisition and other intangible assets that do not qualify for separate recognition. Goodwill is not deductible for tax purposes.

Intevac accounted for the acquisition of SIT as a business combination. Under business combination accounting, the assets and liabilities of SIT were recorded as of the acquisition date, at their respective fair values, and consolidated with the Company. The purchase price allocation was based on estimates of the fair value of assets acquired and liabilities assumed. Subsequent to the acquisition, Intevac paid in full the outstanding notes payable to certain of the selling shareholders assumed upon the acquisition. The purchase price was allocated as follows:

| **(in thousands)** | |
|---|---|
| Cash | $ 38 |
| Other current assets | 2 |
| Property, plant, and equipment | 3 |
| IPR&D | 4,000 |
| Goodwill | 10,484 |
| Long-term deferred tax assets | 697 |
| Total assets acquired | 15,224 |
| Notes payable to sellers | 177 |
| Current liabilities | 526 |
| Long-term deferred tax liabilities | 1,524 |
| Total liabilities assumed | 2,227 |
| Net assets acquired | $ 12,997 |

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**INTEVAC, INC.**

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

In connection with the acquisition of SIT, Intevac agreed to pay up to an aggregate of $7.0 million in cash to the selling shareholders if certain milestones were achieved over a specified period. Intevac has made payments to the selling shareholders for achievement of the first, second and third milestones. The fourth and final milestone was not achieved on the targeted date outlined in the acquisition agreement and will not be paid. There is no remaining contingent consideration obligation associated with the milestone agreement at December 31, 2012.

In connection with the acquisition of SIT, Intevac also 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 December 31, 2012 based on probability-based forecasted revenues reflecting Intevac s own assumptions concerning future revenue from such products. As of December 31, 2012, Intevac has not made any payments associated with the revenue earnout obligation.

The fair value measurement of contingent consideration is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the continent consideration liability as of December 31, 2012. Significant increases or decreases in any of these inputs even in isolation would result in a significantly lower (higher) fair value measurement.

**Quantitative Information about Level 3 Fair Value Measurements at December 31, 2012**

| | Fair Value | Valuation Technique | Unobservable Input | Range (Weighted Average) |
|---|---|---|---|---|
| | | | (In thousands, except for percentages) | |
| Revenue Earnout | $ 5,151 | Discounted cash flow | Weighted average cost of capital | 14.8% |
| | | | Probability weighting of achieving revenue forecasts | 2.0% 43.0% (29.5%) |

Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the statement of operations. The following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the years ended December 31, 2012, 2011 and 2010:

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| | | (In thousands) | |
| Beginning balance | $ 8,715 | $ 9,857 | $ |
| Contingent consideration acquired during the period | | | 9,749 |
| Changes in fair value | (219) | 1,247 | 108 |
| Cash payments made | (3,345) | (2,389) | |
| Ending balance | $ 5,151 | $ 8,715 | $ 9,857 |

Prior to the acquisition, Intevac had an equity interest in SIT with a cost basis of $94,000 that was accounted for under the cost method. As a result of revaluing Intevac s equity interest in SIT on the acquisition date, the Company recognized a gain of $481,000, which was included in other income, net, in the consolidated statement of operations for the year ended December 31, 2010.

Intevac s consolidated financial statements include SIT s operating results from the date of acquisition, November 19, 2010. The pro forma impact of the above acquisition was not significant to Intevac s results for the year ended December 31, 2010.

**8. Sale of Mainframe Technology**

On January 6, 2012, the Company sold certain assets including intellectual property and residual assets which comprised its semiconductor mainframe technology to Brooks.

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**INTEVAC, INC.**

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

The following table summarizes the components of the gain (in thousands):

| | |
|---|---|
| Cash proceeds | $ 3,000 |
| Assets sold: | |
| Inventories | 589 |
| Property, plant and equipment | 178 |
| Transaction and other costs | 26 |
| Gain on sale | $ 2,207 |

**9. Financial Instruments**

***Cash, Cash Equivalents and Investments***

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

| | December 31. 2012 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Holding Gains | Unrealized Holding Losses | Fair Value |
| | | (in thousands) | | |
| Cash and cash equivalents: | | | | |
| Cash | $ 5,939 | $ | $ | $ 5,939 |
| Money market funds | 18,322 | | | 18,322 |
| Total cash and cash equivalents | $ 24,261 | $ | $ | $ 24,261 |
| Short-term investments: | | | | |
| Commercial paper | $ 2,495 | $ | $ | $ 2,495 |
| Corporate bonds and medium-term notes | 19,539 | 13 | 4 | 19,548 |
| Municipal bonds | 1,203 | 1 | | 1,204 |
| U.S. treasury and agency securities | 16,976 | 23 | | 16,999 |
| VRDNs | 345 | | | 345 |
| Total short-term investments | $ 40,558 | $ 37 | $ 4 | $ 40,591 |
| Long-term investments: | | | | |
| Corporate bonds and medium-term notes | $ 16,776 | $ 33 | $ 7 | $ 16,802 |
| Municipal bonds | 1,000 | 2 | | 1,002 |
| U.S. treasury and agency securities | 9,499 | 14 | | 9,513 |
| Total long-term investments | $ 27,275 | $ 49 | $ 7 | $ 27,317 |
| Total cash, cash equivalents, and investments | $ 92,094 | $ 86 | $ 11 | $ 92,169 |

**INTEVAC, INC.**

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

| | December 31, 2011 | | | |
|---|---|---|---|---|
| | Amortized Cost | Unrealized Holding Gains | Unrealized Holding Losses | Fair Value |
| | (In thousands) | | | |
| Cash and cash equivalents: | | | | |
| Cash | $ 14,268 | $ | $ | $ 14,268 |
| Money market funds | 4,845 | | | 4,845 |
| Commercial paper | 4,447 | | | 4,447 |
| Total cash and cash equivalents | $ 23,560 | $ | $ | $ 23,560 |
| Short-term investments: | | | | |
| Commercial paper | $ 1,050 | $ | $ | $ 1,050 |
| Corporate bonds and medium-term notes | 26,665 | 28 | 78 | 26,615 |
| FDIC insured corporate bonds | 9,596 | 23 | | 9,619 |
| Municipal bonds | 4,898 | 10 | | 4,908 |
| U.S. treasury and agency securities | 13,987 | 56 | | 14,043 |
| VRDNs | 2,350 | | | 2,350 |
| Total short-term investments | $ 58,546 | $ 117 | $ 78 | $ 58,585 |
| Long-term investments: | | | | |
| Corporate bonds and medium-term notes | $ 14,761 | $ 16 | $ 77 | $ 14,700 |
| U.S. treasury and agency securities | 13,466 | 22 | 1 | 13,487 |
| ARS | 4,900 | | 410 | 4,490 |
| Total long-term investments | $ 33,127 | $ 38 | $ 488 | $ 32,677 |
| Total cash, cash equivalents, and investments | $ 115,233 | $ 155 | $ 566 | $ 114,822 |

The contractual maturities of available-for-sale securities at December 31, 2012 are presented in the following table.

| | Amortized Cost | Fair Value |
|---|---|---|
| | (In thousands) | |
| Due in one year or less | $ 56,505 | $ 56,540 |
| Due after one through two years | 29,305 | 29,345 |
| Due after ten years | 345 | 345 |
| | $ 86,155 | $ 86,230 |

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 December 31, 2012.

| | December 31, 2012 | | | |
|---|---|---|---|---|
| | In Loss Position for Less than 12 Months | | In Loss Position for Greater than 12 Months | |
| | Fair Value | Gross Unrealized | Fair Value | Gross Unrealized |

| | | Losses | | Losses |
|---|---|---|---|---|
| | | (In thousands) | | |
| Corporate bonds and medium-term notes | $ 13,574 | $ 11 | $ | $ |

All prices for the fixed maturity securities including U.S. Treasury and agency securities, commercial paper, corporate bonds, VRDNs 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

**INTEVAC, INC.**

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

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 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 December 31, 2012.

| | Fair Value Measurements at December 31, 2012 | | |
|---|---|---|---|
| | Total | Level 1 | Level 2 |
| | | (in thousands) | |
| Recurring fair value measurements: | | | |
| Available-for-sale securities | | | |
| Money market funds | $ 18,322 | $ 18,322 | $ |
| U.S. treasury and agency securities | 26,512 | 9,702 | 16,810 |
| Commercial paper | 2,495 | | 2,495 |
| Corporate bonds and medium-term notes | 36,350 | | 36,350 |
| Municipal bonds | 2,206 | | 2,206 |
| VRDNs | 345 | | 345 |
| Total recurring fair value measurements | $ 86,230 | $ 28,024 | $ 58,206 |

The following table presents the changes in Level 3 instruments which consisted of ARS which were classified as available-for-sale securities and which were measured on a recurring basis for the years ended December 31, 2012, 2011 and 2010.

| | 2012 | 2011 | 2010 |
|---|---|---|---|
| | | (in thousands) | |
| Opening balance | $ 4,490 | $ 10,273 | $ 66,249 |
| Total gains (losses) for the period | | | |
| Included in earnings | (381) | (308) | |
| Included in other comprehensive income | 410 | 217 | 3,074 |
| Proceeds from sales | (1,748) | | |
| Proceeds from tender offers | (2,771) | (5,192) | |
| Redemptions at par | | (500) | (59,050) |
| Closing balance | $ | $ 4,490 | $ 10,273 |

***Derivatives***

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. These hedges do not qualify for special hedge accounting treatment. 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 maturities of approximately one month. The notional amount of Company s foreign currency derivatives was $491,000 at December 31, 2012. There were no outstanding foreign currency derivatives at

December 31, 2011.

**INTEVAC, INC.**

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

**10. Income Taxes**

The provision for (benefit from) income taxes on income (loss) from continuing operations consists of the following (in thousands):

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| Federal: | | | |
| Current | $ 3 | $ (899) | $ 5,241 |
| Deferred | 17,160 | (3,633) | (1,706) |
| | 17,163 | (4,532) | 3,535 |
| State: | | | |
| Current | (13) | 8 | 8 |
| Deferred | | | |
| | (13) | 8 | 8 |
| Foreign: | | | |
| Current | (150) | 141 | 419 |
| Deferred | (3,760) | (3,748) | |
| | (3,910) | (3,607) | 419 |
| Total | $ 13,240 | $ (8,131) | $ 3,962 |

Income (loss) before income taxes (benefit) consisted of the following (in thousands):

| | Years Ended December 31, | | |
|---|---|---|---|
| | 2012 | 2011 | 2010 |
| U.S | $ (32,128) | $ (15,078) | $ 384 |
| Foreign | (9,951) | (15,028) | 31,627 |
| | $ (42,079) | $ (30,106) | $ 32,011 |
| Effective tax rate | (31.5)% | 27.0% | 12.4% |

The tax benefits associated with exercises of nonqualified stock options and disqualifying dispositions of stock acquired through incentive stock options and the employee stock purchase plan increased income taxes receivable by $299,000 in 2010. Such benefits were credited to additional paid-in capital.

**INTEVAC, INC.**

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

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts for income tax purposes. Significant components of deferred tax assets are as follows (in thousands):

| | December 31, | |
|---|---|---|
| | **2012** | **2011** |
| Deferred tax assets: | | |
| Vacation, warranty and other accruals | $ 1,489 | $ 1,509 |
| Depreciation and amortization | 1,391 | 503 |
| Intangible amortization | 4,956 | 1,923 |
| Inventory valuation | 1,547 | 1,163 |
| Deferred income | 1,132 | 528 |
| Equity-based compensation | 7,440 | 6,655 |
| Net operating loss, research and other tax credit carryforwards | 35,693 | 27,097 |
| Impairment losses on available-for-sale securities | | 144 |
| Other | | |