INTEVAC INC
Form 10-Q
July 31, 2018

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended June 30, 2018

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	**(IRS Employer**
incorporation or organization)	**Identification No.)**

3560 Bassett Street

Santa Clara, California 95054

(Address of principal executive office, including Zip Code)

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

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

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

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

Large accelerated filer	Accelerated filer
Non-accelerated filer (Do not check if a smaller reporting company)	Smaller reporting company
	Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

On July 27, 2018, 22,583,325 shares of the Registrant s Common Stock, $0.001 par value, were outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

INTEVAC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2018	December 30, 2017
	(Unaudited) (In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 13,731	$ 19,941
Short-term investments	20,069	15,698
Trade and other accounts receivable, net of allowances of $0 at both June 30, 2018 and at December 30, 2017	24,691	20,474
Inventories	33,036	33,792
Prepaid expenses and other current assets	2,434	2,524
Total current assets	93,961	92,429
Property, plant and equipment, net	11,079	12,478
Long-term investments	4,279	6,849
Restricted cash	1,000	1,000
Intangible assets, net of amortization of $7,191 at June 30, 2018 and $6,884 at December 30, 2017	1,196	1,503
Deferred income taxes and other long-term assets	746	764
Total assets	$ 112,261	$ 115,023
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,218	$ 3,949
Accrued payroll and related liabilities	4,825	6,818
Other accrued liabilities	10,538	7,688
Customer advances	10,552	11,026
Total current liabilities	31,133	29,481
Other long-term liabilities	2,542	2,879
Stockholders equity:		
Common stock, $0.001 par value	23	22

Additional paid-in capital	180,426	177,521
Treasury stock, 4,845 shares at both June 30, 2018 and December 30, 2017	(28,489)	(28,489)
Accumulated other comprehensive income	444	490
Accumulated deficit	(73,818)	(66,881)
Total stockholders equity	78,586	82,663
Total liabilities and stockholders equity	$ 112,261	$ 115,023

Note: Amounts as of December 30, 2017 are derived from the December 30, 2017 audited consolidated financial statements.

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(Unaudited)			
	(In thousands, except per share amounts)			
Net revenues:				
Systems and components	$ 23,335	$ 29,863	$ 38,807	$ 58,286
Technology development	2,763	1,100	5,265	3,065
Total net revenues	26,098	30,963	44,072	61,351
Cost of net revenues:				
Systems and components	13,868	18,345	24,596	34,018
Technology development	2,469	1,148	4,840	2,816
Total cost of net revenues	16,337	19,493	29,436	36,834
Gross profit	9,761	11,470	14,636	24,517
Operating expenses:				
Research and development	4,984	4,418	9,151	9,100
Selling, general and administrative	4,712	5,713	10,541	11,987
Total operating expenses	9,696	10,131	19,692	21,087
Income (loss) from operations	65	1,339	(5,056)	3,430
Interest income and other income (expense), net	133	127	278	237
Income (loss) before income taxes	198	1,466	(4,778)	3,667
Provision for income taxes	365	366	525	738
Net income (loss)	$ (167)	$ 1,100	$ (5,303)	$ 2,929
Net income (loss) per share:				
Basic	$ (0.01)	$ 0.05	$ (0.24)	$ 0.14
Diluted	$ (0.01)	$ 0.05	$ (0.24)	$ 0.13
Weighted average common shares outstanding:				
Basic	22,461	21,495	22,284	21,356
Diluted	22,461	23,209	22,284	22,999

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(Unaudited) (In thousands)			
Net income (loss)	$ (167)	$ 1,100	$ (5,303)	$ 2,929
Other comprehensive income (loss), before tax:				
Change in unrealized net loss on available-for-sale investments	22	(1)	(6)	3
Foreign currency translation gains (losses)	(144)	41	(40)	75
Other comprehensive income (loss), before tax	(122)	40	(46)	78
Income taxes related to items in other comprehensive income (loss)				
Other comprehensive income (loss), net of tax	(122)	40	(46)	78
Comprehensive income (loss)	$ (289)	$ 1,140	$ (5,349)	$ 3,007

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended June 30, 2018	Six months ended July 1, 2017
	(Unaudited) (In thousands)	
Operating activities		
Net income (loss)	$ (5,303)	$ 2,929
Adjustments to reconcile net income (loss) to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	2,557	1,973
Net amortization of investment premiums and discounts	(42)	54
Equity-based compensation	1,602	1,864
Change in the fair value of acquisition-related contingent consideration	8	102
Deferred income taxes		(1)
Loss on disposal of fixed assets	442	
Changes in operating assets and liabilities	(3,598)	(10,937)
Total adjustments	969	(6,945)
Net cash and cash equivalents used in operating activities	(4,334)	(4,016)
Investing activities		
Purchases of investments	(17,743)	(15,608)
Proceeds from sales and maturities of investments	15,978	14,967
Purchases of leasehold improvements and equipment	(1,375)	(2,553)
Net cash and cash equivalents used in investing activities	(3,140)	(3,194)
Financing activities		
Net proceeds from issuance of common stock	2,118	1,452
Taxes paid related to net share settlement	(814)	(1,985)
Payment of acquisition-related contingent consideration		(2)
Net cash and cash equivalents provided by (used in) financing activities	1,304	(535)
Effect of exchange rate changes on cash and cash equivalents	(40)	75
Net decrease in cash, cash equivalents and restricted cash	(6,210)	(7,670)
Cash, cash equivalents and restricted cash at beginning of period	20,941	28,645
Cash, cash equivalents and restricted cash at end of period	$ 14,731	$ 20,975

See accompanying notes to the condensed consolidated financial statements.

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Description of Business and Basis of Presentation

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

In the opinion of management, except for the changes below, the unaudited interim condensed consolidated financial statements of Intevac included herein have been prepared on a basis consistent with the December 30, 2017 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. The Company adopted Accounting Standards Codification (ASC) 606, Revenue from Contracts with Customers, with a date of the initial application of December 31, 2017. As a result, the Company has changed its accounting policy for revenue recognition as detailed below. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Intevac s Annual Report on Form 10-K for the fiscal year ended December 30, 2017 (2017 Form 10-K). Intevac s results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of future operating results.

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

2. Recent Accounting Pronouncements

Recently Issued Accounting Standards Not Yet Adopted

In February 2018, the Financial Accounting Standards Board (FASB) issued Accounting Standard Update (ASU) 2018-02, Income Statement Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. ASU 2018-02 allows a reclassification from accumulated other comprehensive income to retained earnings for stranded tax effects resulting from the Tax Cuts and Jobs Act (Tax Reform). The guidance states that because the adjustment of deferred taxes due to the reduction of the historical corporate income tax rate to the newly enacted corporate income tax rate is required to be included in income from continuing operations, the tax effects of items within accumulated other comprehensive income (stranded tax effects) do not reflect the appropriate tax rate. As stated within the guidance, the amendments in this update should be applied retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Tax

Reform is recognized. This update becomes effective in the first quarter of fiscal 2019. Early adoption is permitted. At this time, the Company is in the process of evaluating the impact of the provisions of ASU 2018-02 on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases. The new standard requires lessees to record assets and liabilities on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement.

Intevac leases certain facilities under non-cancelable operating leases that expire at various times up to March 2024 and has options to renew most leases, with rentals to be negotiated. Certain of Intevac s leases contain provisions for rental adjustments. Operating lease rentals are expensed on a straight-line basis over the life of the lease beginning on the date we take possession of the property. At lease inception, we determine the lease term by assuming the exercise of those renewal options that are reasonably assured. The exercise of lease renewal options is at our sole discretion. The lease term is used to determine whether a lease is capital or operating and is used to calculate straight-line rent expense. Additionally, the depreciable life of leasehold improvements is limited by the expected lease term.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

We plan to adopt the standard as of December 30, 2018, the beginning of fiscal 2019. We will elect the package of practical expedients permitted under the transition guidance within the new standard, which, among other things, allows us to carry forward the historical lease classification. In addition, we are electing the hindsight practical expedient to determine the reasonably certain lease term for existing leases. We will make an accounting policy election to keep leases with an initial term of 12 months or less off of the balance sheet. We will recognize those lease payments in the consolidated statements of operations on a straight-line basis over the lease term. We also plan to elect the proposed practical expedient that will allow us to apply the new lease guidance at its effective date, December 30, 2018, without adjusting the comparative financial statements.

We are currently completing the assessment phase of the implementation project and are finalizing our review of the impact of adoption. We expect the adoption of these accounting changes will materially increase our assets and liabilities, but will not have a material impact on our results of operations, equity, or cash flows.

Adoption of New Accounting Standard

On December 31, 2017, we adopted the new accounting standard ASC 606, Revenue from Contracts with Customers and all the related amendments (new revenue standard) to all contracts using the modified retrospective method. We recognized the cumulative effect of initially applying the new revenue standard as an adjustment to the opening balance of the accumulated deficit. The comparative information has not been restated and continues to be reported under the accounting standards in effect for those periods. We expect the impact of the adoption of the new standard to be immaterial to our net income on an ongoing basis.

In our TFE segment, a majority of our equipment sales revenue continues to be recognized when products are shipped from our manufacturing facilities. Revenue recognition for our equipment sales arrangements, which includes systems, technology upgrades, service and spare parts, remains materially consistent with our historical practice.

Under the new revenue standard, in our TFE segment, we recognize revenue for equipment sales at a point in time following the transfer of control of such products to the customer, which typically occurs upon shipment or delivery depending on the terms of the underlying contracts. Our contracts with customers may include multiple performance obligations. For such arrangements, under the new revenue standard we allocate revenue to each performance obligation based on its relative standalone selling price. We generally determine standalone selling prices based on the prices charged to customers or by using expected cost plus margin. Under the new revenue standard, the expected costs associated with our base warranties continue to be recognized as expense when the equipment is sold.

Under the new revenue standard, in our Photonics segment, we recognize revenue for cost plus fixed fee (CPFF) and firm fixed priced (FFP) government contracts over time under the cost-to-cost method for the majority of our government contracts, which is consistent with our historical revenue recognition model. Revenue on the majority of our government contracts will continue to be recognized over time because of the continuous transfer of control to the customer. For U.S. government contracts, this continuous transfer of control to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work in process. Similarly, for non-U.S. government contracts, the customer typically controls the work in process as evidenced either by contractual termination clauses or by our rights to payment for work performed to date to deliver products or services that do not have an alternative use to the Company. Under the new standard, the cost-to-cost measure of progress continues to best depict the transfer of control of assets to the customer, which occurs as we incur costs.

The majority of our contracts in our Photonics segment have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from other promises in the contracts and, therefore, not distinct. Some of our contracts have multiple performance obligations, most commonly due to the contract covering multiple phases of the product lifecycle (development and production). For contracts with multiple performance obligations, we allocate the contract s transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. The primary method used to estimate standalone selling price is the expected cost plus a margin approach, under which we forecast our expected costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Under the new revenue standard, in our Photonics segment, we recognize revenue for homogenous manufactured military products sold to the U.S. government and its contractors over time under the units-of-delivery method because of the continuous transfer of control to the customer. Intevac believes that the units-of-delivery method is an appropriate measure for measuring progress for the manufactured units as an equal amount of value is individually transferred to the customer upon delivery. The Company previously recognized revenue for substantially all manufactured military products sold to the U.S. government and its contractors when the customers took delivery of the products, which was generally upon shipment.

The nature of our contracts in our Photonics segment gives rise to several types of variable consideration including tiered pricing. Allocation of contract revenues among Photonics military products, and the timing of the recognition of those revenues, is impacted by agreements with tiered pricing or variable rate structures. We include variable consideration in the estimated transaction price when there is a basis to reasonably estimate the amount of the consideration. These estimates are based on historical experience, anticipated performance and our best judgment at the time. Because of our certainty in estimating these amounts, they are included in the transaction price of our contracts and the associated remaining performance obligations.

Accounting for CPFF and FFP contracts and programs involves the use of various techniques to estimate total contract revenue and costs. For these contracts, we estimate the profit on a contract as the difference between the total estimated revenue and expected costs to complete a contract and recognize that profit over the life of the contract. Contract estimates are based on various assumptions to project the outcome of future events. These assumptions include the complexity of the work to be performed; the cost and availability of materials; the performance of subcontractors; and the availability and timing of funding from the customer.

As a significant change in one or more of these estimates could affect the profitability of our contracts, we review and update our contract-related estimates regularly. We recognize adjustments in estimated profit on contracts under the cumulative catch-up method. Under this method, the impact of the adjustment on profit recorded to date on a contract is recognized in the period the adjustment is identified. Revenue and profit in future periods of contract performance are recognized using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the total loss in the quarter it is identified.

We recorded a cumulative effect adjustment to the beginning balance of our consolidated December 31, 2017 balance sheet for the impact of the allocation and the timing of the recognition of revenues for an open Photonics military product agreement with a tiered pricing structure. This change will also result in increased revenue in subsequent periods from this agreement. The cumulative effect of the changes made to our consolidated December 31, 2017 balance sheet for the adoption of the new revenue standard were as follows (in thousands):

	Balance at December 30,	Adjustments Due to	Balance at December 31,

	2017	ASC 606	2017
Other accrued liabilities	$ 7,688	$ 1,634	$ 9,322
Accumulated deficit	$ (66,881)	$ (1,634)	$ (68,515)

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on select condensed consolidated statement of operations line items was as follows (in thousands):

	Three Months Ended			Six Months Ended		
	June 30, 2018					
	As Reported	Balances without ASC 606	Effect of Change	As Reported	Balances without ASC 606	Effect of Change
	(In thousands)					
Systems and components revenues	$ 23,335	$ 23,235	$ 100	$ 38,807	$ 38,578	$ 229
Total net revenues	$ 26,098	$ 25,998	$ 100	$ 44,072	$ 43,843	$ 229
Gross profit	$ 9,761	$ 9,661	$ 100	$ 14,636	$ 14,407	$ 229
Income (loss) from operations	$ 65	$ (35)	$ 100	$ (5,056)	$ (5,285)	$ 229
Income (loss) before income taxes	$ 198	$ 98	$ 100	$ (4,778)	$ (5,007)	$ 229
Net loss	$ (167)	$ (267)	$ 100	$ (5,303)	$ (5,532)	$ 229

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In accordance with the new revenue standard requirements, the disclosure of the impact of adoption on select condensed consolidated balance sheet line items was as follows (in thousands):

	As of June 30, 2018		
	As Reported	Balances without ASC 606	Effect of Change
Other accrued liabilities	$ 10,538	$ 9,133	$ 1,405
Total current liabilities	$ 31,133	$ 29,728	$ 1,405
Accumulated deficit	$ (73,818)	$ (72,413)	$ (1,405)
Total stockholders equity	$ 78,586	$ 79,991	$ (1,405)

3. Revenue

The following tables represent a disaggregation of revenue from contracts with customers for the three and six months ended June 30, 2018 and July 1, 2017 along with the reportable segment for each category. As noted above, the prior period amounts have not been adjusted under the modified retrospective method.

Major Products and Service Lines

TFE	Three Months Ended June 30, 2018				Three Months Ended July 1, 2017			
	(In thousands)							
	HDD	DCP	PV	Total	HDD	DCP	PV	Total
Systems, upgrades and spare parts	$ 19,221	$	$ 1	$ 19,222	$ 11,975	$ 351	$ 8,996	$ 21,322
Field service	1,625		1	1,626	1,104			1,104
Total TFE net revenues	$ 20,846	$	$ 2	$ 20,848	$ 13,079	$ 351	$ 8,996	$ 22,426

	Six Months Ended June 30, 2018				Six Months Ended July 1, 2017			
	(In thousands)							
	HDD	DCP	PV	Total	HDD	DCP	PV	Total
Systems, upgrades and spare parts	$ 29,614	$ 1	$ 3	$ 29,618	$ 19,256	$ 13,138	$ 8,996	$ 41,390
Field service	3,980		39	4,019	2,520			2,520
Total TFE net revenues	$ 33,594	$ 1	$ 42	$ 33,637	$ 21,776	$ 13,138	$ 8,996	$ 43,910

Photonics	Three Months Ended June 30, 2018	Three Months Ended July 1, 2017	Six Months Ended June 30, 2018	Six Months Ended July 1, 2017
	(In thousands)			
Products:				
Military products	$ 2,145	$ 7,213	$ 4,399	$ 13,920
Commercial products	54	16	54	62
Repair and other services	288	208	717	394
Total Photonics product net revenues	2,487	7,437	5,170	14,376
Technology development:				
CPFF	2,220	187	4,010	1,068
FFP	540	913	1,232	1,997
Time and materials	3		23	
Total technology development net revenues	2,763	1,100	5,265	3,065
Total Photonics net revenues	$ 5,250	$ 8,537	$ 10,435	$ 17,441

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Primary Geographical Markets

	Three Months Ended June 30, 2018			Three Months Ended July 1, 2017		
	(In thousands)					
	TFE	Photonics	Total	TFE	Photonics	Total
United States	$ 1,351	$ 4,998	$ 6,349	$ 2,050	$ 8,333	$ 10,383
Asia	19,497	31	19,528	20,376	8	20,384
Europe		187	187		196	196
Rest of World		34	34			
Total net revenues	$ 20,848	$ 5,250	$ 26,098	$ 22,426	$ 8,537	$ 30,963

	Six Months Ended June 30, 2018			Six Months Ended July 1, 2017		
	(In thousands)					
	TFE	Photonics	Total	TFE	Photonics	Total
United States	$ 3,262	$ 9,760	$ 13,022	$ 2,663	$ 16,922	$ 19,585
Asia	30,375	31	30,406	41,247	8	41,255
Europe		480	480		511	511
Rest of World		164	164			
Total net revenues	$ 33,637	$ 10,435	$ 44,072	$ 43,910	$ 17,441	$ 61,351

Timing of Revenue Recognition

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	(In thousands)					
	TFE	Photonics	Total	TFE	Photonics	Total
Products transferred at a point in time	$ 20,848	$ 288	$ 21,136	$ 33,637	$ 717	$ 34,354
Products and services transferred over time		4,962	4,962		9,718	9,718
	$ 20,848	$ 5,250	$ 26,098	$ 33,637	$ 10,435	$ 44,072

The following table reflects the changes in our contract assets, which we classify as accounts receivable, unbilled or retainage, and our contract liabilities, which we classify as deferred revenue and customer advances, for the six months ended June 30, 2018:

	June 30, 2018	December 30, 2017	Six Months Change
		(In thousands)	
TFE:			
Contract assets:			
Accounts receivable, unbilled	$ 529	$ 1,368	$ (839)
Contract liabilities:			
Deferred revenue	$ 5,246	$ 5,190	$ 56
Customer advances	9,672	10,204	(532)
	$ 14,918	$ 15,394	$ (476)
Photonics:			
Contract assets:			
Accounts receivable, unbilled	$ 1,523	$ 1,346	$ 177
Retainage	294	281	13
	$ 1,817	$ 1,627	$ 190
Contract liabilities:			
Deferred revenue	$ 1,443	$ 97	$ 1,346
Customer advances	880	822	58
	$ 2,323	$ 919	$ 1,404

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Accounts receivable, unbilled in our TFE segment represents a contract asset for revenue that has been recognized in advance of billing the customer. For our system and certain upgrade sales, our TFE customers generally pay 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 due upon completion of installation and acceptance of the system at the customer s factory. Accounts receivable, unbilled in our TFE segment generally represents the balance of the system price that is due upon completion of installation and acceptance less the amount that has been deferred as revenue for the performance of the installation tasks. During the six months ended June 30, 2018, contract assets in our TFE segment decreased by $839,000 primarily due to the final billing on four systems that were pending acceptance as of December 30, 2017 that completed installation and were accepted by the customer, offset by the accrual of revenue for an additional two systems delivered during the first half of fiscal 2018 that were pending acceptance as of June 30, 2018.

Customer advances in our TFE segment generally represent amounts billed to the customer prior to transferring goods which represents a contract liability. We have elected to use the practical expedient to disregard the effect of the time value of money in a significant financing component when its payment terms are less than one year. These contract advances are liquidated when revenue is recognized. Deferred revenue in our TFE segment generally represents amounts billed to a customer for completed systems at the customer site that are undergoing installation and acceptance testing where transfer of control has not yet occurred as we do not yet have a demonstrated history of meeting the acceptance criteria upon the customer s receipt of product and represents a contract liability. During the six months ended June 30, 2018, we recognized revenue in our TFE segment of $6.6 million and $69,000 that was included in customer advances and deferred revenue, respectively, at the beginning of the period.

Accounts receivable, unbilled in our Photonics segment represents a contract asset for revenue that has been recognized in advance of billing the customer, which is common for contracts in the defense industry. In our Photonics segment, amounts are billed as work progresses in accordance with agreed-upon contractual terms, either at periodic intervals (e.g., monthly) or upon achievement of contractual milestones. Generally, billing occurs subsequent to revenue recognition, resulting in contract assets. Our contracts with the U.S. government may also contain retainage provisions. Retainage represents a contract asset for the portion of the contract price earned by us for work performed, but held for payment by the U.S. government as a form of security until satisfactory completion of the contract. The retainage is billable upon completion of the contract performance and approval of final indirect expense rates by the government. During the six months ended June 30, 2018, contract assets in our Photonics segment increased by $190,000 primarily due to the accrual of revenue for incurred costs under CPFF contracts.

Customer advances in our Photonics segment generally represent deposits from customers upon contract execution and upon achievement of contractual milestones which represents a contract liability. These deposits are liquidated when revenue is recognized. Deferred revenue in our Photonics segment includes $1.4 million deferred for the impact of the allocation and the timing of the recognition of revenues for a military product agreement with a tiered pricing structure. Deferred revenue in our Photonics segment also includes incurred costs under CPFF contracts pending approval of final indirect expense rates by the government and represents a contract liability. During the six months ended June 30, 2018, we recognized revenue in our Photonics segment of $206,000 and $229,000 that was included in customer advances and deferred revenue, respectively, at the beginning of the period.

On June 30, 2018 we had $64.6 million of remaining performance obligations, which we also refer to as total backlog. Backlog at June 30, 2018 consisted of $54.2 million of TFE backlog and $10.3 million of Photonics backlog. We expect to recognize approximately 72.8% of our remaining performance obligations as revenue in 2018, and the balance in 2019.

4. Inventories

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

	June 30, 2018	December 30, 2017
	(In thousands)	
Raw materials	$ 16,106	$ 19,881
Work-in-progress	12,622	9,433
Finished goods	4,308	4,478
	$ 33,036	$ 33,792

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

5. Equity-Based Compensation

At June 30, 2018, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan and the 2004 Equity Incentive Plan (together, the Plans) and the 2003 Employee Stock Purchase Plan (the ESPP). Intevac s stockholders approved all of these plans. The Plans permit the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, restricted stock units (RSUs) and performance shares.

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

Compensation Expense

The effect of recording equity-based compensation for the three and six months ended July 30, 2018 and July 1, 2017 was as follows:

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands)			
Equity-based compensation by type of award:				
Stock options	$ 216	$ 202	$ 350	$ 458
RSUs	230	495	636	1,212
Employee stock purchase plan	339	90	616	194
Total equity-based compensation	$ 785	$ 787	$ 1,602	$ 1,864

Equity-based compensation expense is based on awards ultimately expected to vest and such amount has been historically reduced for estimated forfeitures. Beginning January 1, 2017, Intevac accounts for forfeitures as they occur, rather than estimating expected forfeitures. The net cumulative effect of this change was recognized as a

$1.1 million increase to the accumulated deficit as of January 1, 2017.

Stock Options and ESPP

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

Option activity as of June 30, 2018 and changes during the six months ended June 30, 2018 were as follows:

	Shares	Weighted Average Exercise Price
Options outstanding at December 30, 2017	2,925,861	$ 7.62
Options granted	384,875	$ 5.15
Options cancelled and forfeited	(667,384)	$ 9.60
Options exercised	(256,889)	$ 4.89
Options outstanding at June 30, 2018	2,386,463	$ 6.96
Options exercisable at June 30, 2018	1,643,069	$ 6.84

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Intevac issued 216,988 shares under the ESPP during the six months ended June 30, 2018.

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	**July 1, 2017**	**June 30, 2018**	**July 1, 2017**
Stock Options:				
Weighted-average fair value of grants per share	$ 1.87	$ 4.64	$ 1.99	$ 4.63
Expected volatility	44.50%	41.79%	43.80%	40.43%
Risk free interest rate	2.58%	1.87%	2.58%	1.77%
Expected term of options (in years)	4.5	4.4	4.5	4.1
Dividend yield	None	None	None	None

	Six Months Ended	
	June 30, 2018	**July 1, 2017**
Stock Purchase Rights:		
Weighted-average fair value of grants per share	$ 2.36	$ 2.74
Expected volatility	46.60%	40.66%
Risk free interest rate	1.82%	1.14%
Expected term of purchase rights (in years)	1.25	0.74
Dividend yield	None	None

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

RSUs

A summary of the RSU activity is as follows:

	Shares	Weighted Average Grant Date Fair Value
Non-vested RSUs at December 30, 2017	769,451	$ 7.84
Granted	196,291	$ 5.07
Vested	(422,236)	$ 7.12
Cancelled and forfeited	(90,880)	$ 8.92
Non-vested RSUs at June 30, 2018	452,626	$ 7.10

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In fiscal 2016, the annual bonus for certain participants in the Company s annual incentive plan was settled with RSUs with one-year vesting. The bonus accrual was classified as a liability until the number of shares was determined on the date the awards were granted, at which time the Company classified the awards into equity. In February 2017, the annual 2016 bonus for certain participants was settled with RSUs with one-year vesting. 33 participants were granted stock awards to receive an aggregate of 134,000 shares of common stock with a weighted average grant date fair value of $9.63 per share. The Company recorded equity-based compensation expense related to the annual incentive plans of $102,000 for the six months ended July 1, 2017.

6. Purchased Intangible Assets

Details of finite-lived intangible assets by segment as of June 30, 2018, are as follows.

	June 30, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
		(In thousands)	
TFE	$ 7,172	$ (6,077)	$ 1,095
Photonics	1,215	(1,114)	101
	$ 8,387	$ (7,191)	$ 1,196

Total amortization expense of finite-lived intangibles for the three and six months ended June 30, 2018 was $154,000 and $307,000.

As of June 30, 2018, future amortization expense is expected to be as follows.

(In thousands)	
2018	$ 307
2019	615
2020	274
	$ 1,196

7. Acquisition-Related Contingent Consideration

In connection with the acquisition of Solar Implant Technologies, Inc. (SIT), Intevac agreed to pay to the selling shareholders in cash a revenue earnout on Intevac s net revenue from commercial sales of certain products over a specified period up to an aggregate of $9.0 million. Intevac estimated the fair value of this contingent consideration on June 30, 2018 based on forecasted revenues reflecting Intevac s own assumptions concerning future revenue from such products. As of June 30, 2018, payments made associated with the revenue earnout obligation have not been significant.

The fair value measurement of contingent consideration is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the condensed consolidated statements of operations. The following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the three and six months ended June 30, 2018 and July 1, 2017:

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands)			
Opening balance	$ 361	$ 837	$ 362	$ 759
Changes in fair value	9	22	8	102
Cash payments made				(2)
Closing balance	$ 370	$ 859	$ 370	$ 859

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table displays the balance sheet classification of the contingent consideration liability account at June 30, 2018 and at December 30, 2017:

	June 30, 2018	December 30, 2017
	(In thousands)	
Other accrued liabilities	$ 370	$ 103
Other long-term liabilities		259
Total acquisition-related contingent consideration	$ 370	$ 362

The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the contingent consideration liability as of June 30, 2018. Significant increases (or decreases) in any of these inputs in isolation would result in a significantly lower (or higher) fair value measurement.

	Quantitative Information about Level 3 Fair Value Measurements at June 30, 2018			
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
	(In thousands, except for percentages)			
Revenue Earnout	$ 370	Discounted cash flow	Weighted average cost of capital	12.1%

8. Warranty

Intevac provides for the estimated cost of warranty when revenue is recognized. Intevac s warranty is per contract terms and for its HDD, DCP and solar cell manufacturing systems the warranty typically ranges between 12 and 24 months from customer acceptance. During this warranty period any defective non-consumable parts are replaced and installed at no charge to the customer. Intevac uses estimated repair or replacement costs along with its historical warranty experience to determine its warranty obligation. The provision for the estimated future costs of warranty is based upon historical cost and product performance experience. Intevac exercises judgment in determining the underlying estimates.

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

The following table displays the activity in the warranty provision account for the three and six months ended June 30, 2018 and July 1, 2017:

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands)			
Opening balance	$ 866	$ 1,106	$ 994	$ 1,007
Expenditures incurred under warranties	(182)	(138)	(418)	(280)
Accruals for product warranties issued during the reporting period	174	256	278	506
Adjustments to previously existing warranty accruals	53	(4)	57	(13)
Closing balance	$ 911	$ 1,220	$ 911	$ 1,220

The following table displays the balance sheet classification of the warranty provision account at June 30, 2018 and at December 30, 2017:

	June 30, 2018	December 30, 2017
	(In thousands)	
Other accrued liabilities	$ 685	$ 757
Other long-term liabilities	226	237
Total warranty provision	$ 911	$ 994

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

9. Guarantees

Officer and Director Indemnifications

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

Other Indemnifications

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

Letters of Credit

As of June 30, 2018, we had letters of credit and bank guarantees outstanding totaling $1.0 million, including the standby letter of credit outstanding under the Santa Clara, California facility lease and various other guarantees with our bank. These letters of credit and bank guarantees are collateralized by $1.0 million of restricted cash.

10. Cash, Cash Equivalents and Investments

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

	June 30, 2018			
	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
	(In thousands)			
Cash and cash equivalents:				

Cash	$ 8,563	$	$	$ 8,563
Money market funds	5,168			5,168
Total cash and cash equivalents	$ 13,731	$	$	$ 13,731
Short-term investments:				
Certificates of deposit	$ 7,145	$ 2	$ 2	$ 7,145
Commercial paper	493			493
Corporate bonds and medium-term notes	6,060		25	6,035
Municipal bonds	500		1	499
U.S. treasury and agency securities	5,912		15	5,897
Total short-term investments	$ 20,110	$ 2	$ 43	$ 20,069
Long-term investments:				
Corporate bonds and medium-term notes	$ 2,792	$ 4	$ 5	$ 2,791
Municipal bonds	499		2	497
U.S. treasury and agency securities	998		7	991
Total long-term investments	$ 4,289	$ 4	$ 14	$ 4,279
Total cash, cash equivalents, and investments	$ 38,130	$ 6	$ 57	$ 38,079

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	December 30, 2017			
	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
	(In thousands)			
Cash and cash equivalents:				
Cash	$ 13,195	$	$	$ 13,195
Money market funds	6,746			6,746
Total cash and cash equivalents	$ 19,941	$	$	$ 19,941
Short-term investments:				
Certificates of deposit	$ 2,500	$ 1	$ 1	$ 2,500
Commercial paper	3,291			3,291
Corporate bonds and medium-term notes	4,502		5	4,497
Municipal bonds	500		3	497
U.S. treasury and agency securities	4,917		4	4,913
Total short-term investments	$ 15,710	$ 1	$ 13	$ 15,698
Long-term investments:				
Asset backed securities	$ 500	$	$	$ 500
Corporate bonds and medium-term notes	4,384		21	4,363
U.S. treasury and agency securities	1,998		12	1,986
Total long-term investments	$ 6,882	$	$ 33	$ 6,849
Total cash, cash equivalents, and investments	$ 42,533	$ 1	$ 46	$ 42,488

The contractual maturities of available-for-sale securities at June 30, 2018 are presented in the following table.

	June 30, 2018	
	Amortized Cost	Fair Value
	(In thousands)	
Due in one year or less	$ 25,278	$ 25,237
Due after one through two years	4,289	4,279
	$ 29,567	$ 29,516

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 June 30, 2018.

	June 30, 2018			
	In Loss Position for Less than 12 Months		In Loss Position for Greater than 12 Months	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
	(In thousands)			
Certificates of deposit	$ 3,898	$ 2	$	$
Corporate bonds and medium-term notes	6,011	25	1,356	5
Municipal bonds	497	2	499	1
U.S. treasury and agency securities	3,270	20	597	2
	$ 13,676	$ 49	$ 2,452	$ 8

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

All prices for the fixed maturity securities including U.S. Treasury and agency securities, certificates of deposit, commercial paper, corporate bonds and municipal bonds are received from independent pricing services utilized by Intevac s outside investment manager. This investment manager performs a review of the pricing methodologies and inputs utilized by the independent pricing services for each asset type priced by the vendor. In addition, on at least an annual basis, the investment manager conducts due diligence visits and interviews with each pricing vendor to verify the inputs 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 for a security in an orderly sale. 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 June 30, 2018.

	Fair Value Measurements at June 30, 2018		
	Total	**Level 1**	**Level 2**
	(In thousands)		
Recurring fair value measurements:			
Available-for-sale securities			
Money market funds	$ 5,168	$ 5,168	$
U.S. treasury and agency securities	6,888	5,893	995
Certificates of deposit	7,145		7,145
Commercial paper	493		493
Corporate bonds and medium-term notes	8,826		8,826
Municipal bonds	996		996
Total recurring fair value measurements	$ 29,516	$ 11,061	$ 18,455

11. Derivative Instruments

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

The following table summarizes the Company s outstanding derivative instruments on a gross basis as recorded in its condensed consolidated balance sheets as of June 30, 2018 and December 30, 2017:

	Notional Amounts		Derivative Liabilities			
Derivative Instrument	**June 30, 2018**	**December 30, 2017**	**June 30, 2018**		**December 30, 2017**	
			Balance Sheet Line	**Fair Value**	**Balance Sheet Line**	**Fair Value**
			(in thousands)			
Undesignated Hedges:						
Forward Foreign Currency Contracts	$ 1,106	$ 1,276	(a)	$ 4	(a)	$ 5
Total Hedges	$ 1,106	$ 1,276		$ 4		$ 5

(a) Other accrued liabilities

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

12. Equity

Stock Repurchase Program

On November 21, 2013, Intevac s Board of Directors approved a stock repurchase program authorizing up to $30.0 million in repurchases. At June 30, 2018, $1.5 million remains available for future stock repurchases under the repurchase program. Intevac did not make any stock repurchases during the three and six months ended June 30, 2018 and July 1, 2017.

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

Accumulated Other Comprehensive Income

The changes in accumulated other comprehensive income by component for the three and six months ended June 30, 2018 and July 1, 2017, are as follows.

	Three Months Ended June 30, 2018			Six Months Ended June 30, 2018		
	Foreign currency	Unrealized holding losses on available-for-sale investments	Total	Foreign currency	Unrealized holding losses on available-for-sale investments	Total
	(In thousands)					
Beginning balance	$ 639	$ (73)	$ 566	$ 535	$ (45)	$ 490
Other comprehensive income (loss) before reclassification	(144)	22	(122)	(40)	(6)	(46)
Amounts reclassified from other comprehensive income						
Net current-period other comprehensive income (loss)	(144)	22	(122)	(40)	(6)	(46)
Ending balance	$ 495	$ (51)	$ 444	$ 495	$ (51)	$ 444

	Three Months Ended			Six Months Ended		
	July 1, 2017					
	Foreign currency	Unrealized holding losses on available-for-sale investments	Total	Foreign currency	Unrealized holding losses on available-for-sale investments	Total
	(In thousands)					
Beginning balance	$ 377	$ (18)	$ 359	$ 343	$ (22)	$ 321
Other comprehensive income (loss) before reclassification	41	(1)	40	75	3	78
Amounts reclassified from other comprehensive income						
Net current-period other comprehensive income (loss)	41	(1)	40	75	3	78
Ending balance	$ 418	$ (19)	$ 399	$ 418	$ (19)	$ 399

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

13. Net Income (Loss) Per Share

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands, except per share amounts)			
Net income (loss)	$ (167)	$ 1,100	$ (5,303)	$ 2,929
Weighted-average shares basic	22,461	21,495	22,284	21,356
Effect of dilutive potential common shares		1,714		1,643
Weighted-average shares diluted	22,461	23,209	22,284	22,999
Net income (loss) per share basic	$ (0.01)	$ 0.05	$ (0.24)	$ 0.14
Net income (loss) per share diluted	$ (0.01)	$ 0.05	$ (0.24)	$ 0.13

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

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands)			
Stock options to purchase common stock	2,386	398	2,386	542
RSUs	453		453	
Employee stock purchase plan	653		653	

14. Segment Reporting

Intevac s two reportable segments are: TFE and Photonics. Intevac s chief operating decision-maker has been identified as the President and CEO, who reviews operating results to make decisions about allocating resources and assessing performance for the entire Company. Segment information is presented based upon Intevac s management organization structure as of June 30, 2018 and the distinctive nature of each segment. Future changes to this internal financial structure may result in changes to the reportable segments disclosed.

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

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

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

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

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

Information for each reportable segment for the three and six months ended June 30, 2018 and July 1, 2017 is as follows:

Net Revenues

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands)			
TFE	$ 20,848	$ 22,426	$ 33,637	$ 43,910
Photonics	5,250	8,537	10,435	17,441
Total segment net revenues	$ 26,098	30,963	$ 44,072	$ 61,351

Operating Income (Loss)

	Three Months Ended		Six Months Ended	
	June 30, 2018	July 1, 2017	June 30, 2018	July 1, 2017
	(In thousands)			
TFE	$ 1,220	$ 1,749	$ (1,289)	$ 3,608
Photonics	(444)	764	(1,654)	2,228
Total income (loss) from segment operations	776	2,513	(2,943)	5,836
Unallocated costs	(711)	(1,174)	(2,113)	(2,406)
Income (loss) from operations	65	1,339	(5,056)	3,430
Interest income and other income (expense), net	133	127	278	237
Income (loss) before income taxes	$ 198	$ 1,466	$ (4,778)	$ 3,667

Total assets for each reportable segment as of June 30, 2018 and December 30, 2017 are as follows:

Assets

	June 30, 2018	December 30, 2017
	(In thousands)	
TFE	$ 54,084	$ 52,156
Photonics	15,888	16,364
Total segment assets	69,972	68,520
Cash, cash equivalents and investments	38,079	42,488
Restricted cash	1,000	1,000
Deferred income taxes	4	4
Other current assets	1,347	1,001
Common property, plant and equipment	1,134	1,267
Other assets	725	743
Consolidated total assets	$ 112,261	$ 115,023

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

15. Income Taxes

Intevac recorded income tax provisions of $365,000 and $525,000 for the three and six months ended June 30, 2018, respectively, and $366,000 and $738,000 for the three and six months ended July 1, 2017, respectively. The income tax provisions for the three and six months are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates. For the three and six months ended June 30, 2018 Intevac utilized net operating loss carry-forwards to offset the impact of the global intangible low-taxed income (GILTI) and recorded discrete items for withholding taxes on royalties paid to the United States from Intevac s Singapore subsidiary. For the three and six months ended July 1, 2017 Intevac utilized net operating loss carry-forwards to reduce taxable U.S. income to the AMT level and recorded discrete items for audit considerations in foreign jurisdictions and stock-based compensation excess tax benefits. 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 carry-forwards, 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.

Tax Reform was enacted on December 22, 2017. Tax Reform reduces the U.S. federal corporate tax rate from 35% to 21%, requires companies to pay a one-time transition tax on earnings of certain foreign subsidiaries that were previously tax deferred and creates new taxes on certain foreign sourced earnings. At June 30, 2018, we have not completed our accounting for the tax effects of enactment of Tax Reform; however, in certain cases, we have made a reasonable estimate of the effects on our existing deferred tax balances and the one-time transition tax. In other cases, we have not been able to make a reasonable estimate and continue to account for those items based on our existing accounting under ASC 740, Income Taxes.

Additionally, Tax Reform subjects a U.S. shareholder to tax on GILTI earned by certain foreign subsidiaries for tax years starting on or after January 1, 2018. The FASB Staff Q&A, Topic 740, No. 5, Accounting for Global Intangible Low-Taxed Income, states that an entity can make an accounting policy election to either recognize deferred taxes for temporary basis differences expected to reverse as GILTI in future years or provide for the tax expense related to GILTI in the year the tax is incurred. The Company is still evaluating the effects of the GILTI provisions and has not yet determined its accounting policy relating to deferred taxes.

The Company historically asserted its intent to reinvest substantially all of its foreign earnings in foreign operations indefinitely. The Company is still in the process of analyzing the impact that Tax Reform has on its indefinite reinvestment assertion. Accordingly, no additional income taxes or withholding taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax, or any outside basis difference inherent in these entities.

The Inland Revenue Authority of Singapore (IRAS) is currently conducting a review of the fiscal 2009 through 2012 tax returns of the Company s wholly-owned subsidiary, Intevac Asia Pte. Ltd. IRAS has challenged the Company s tax position with respect to certain aspects of the Company s transfer pricing. Under Singapore tax law, the Company must pay all contested taxes and the related interest to have the right to defend its position. The contested tax deposits of $725,000 at June 30, 2018 and $743,000 at December 30, 2017 are included in other long-term assets on the condensed consolidated balance sheets. The Company s management and its advisors continue to believe that the Company is more likely than not to successfully defend that the tax treatment was proper and in accordance with Singapore tax regulations. Presently, there are no other active income tax examinations in the jurisdictions where Intevac operates.

16. Contingencies

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

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

17. Restructuring Charges

During the first quarter of fiscal 2018, Intevac substantially completed implementation of the 2018 cost reduction plan (the Plan), which was intended to reduce expenses and reduce its workforce by 6 percent. The cost of implementing the Plan was reported under cost of net revenues and operating expenses in the condensed consolidated statements of operations. Substantially all cash outlays in connection with the Plan occurred in the first quarter of fiscal 2018. Implementation of the Plan is expected to reduce salary, wages and other employee-related expenses by approximately $1.8 million on an annual basis.

The changes in restructuring reserves associated with the Plan for the six months ended June 30, 2018 are as follows.

	Six Months Ended June 30, 2018 Severance and other employee-related costs (In thousands)
Beginning balance	$
Provision for restructuring reserves	95
Cash payments made	(95)
Ending balance	$

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

This Quarterly Report on Form 10-Q contains forward-looking statements, which involve risks and uncertainties. Words such as believes, expects, anticipates and the like indicate forward-looking statements. These forward-lookin statements include comments related to Intevac s shipments, projected revenue recognition, product costs, gross margin, operating expenses, interest income, income taxes, cash balances and financial results in 2018 and beyond; projected customer requirements for Intevac s new and existing products, and when, and if, Intevac s customers will place orders for these products; Intevac s ability to proliferate its Photonics technology into major military programs and to develop and introduce commercial imaging products; the timing of delivery and/or acceptance of the systems and products that comprise Intevac s backlog for revenue; and the Company s ability to achieve cost savings. Intevac s actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under Risk Factors and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed on February 14, 2018, and our periodic reports on Form 10-Q and current reports Form 8-K.

Overview

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

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

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

The following table presents certain significant measurements for the three and six months ended June 30, 2018 and July 1, 2017:

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior	June 30, 2018	July 1, 2017	Change over prior period

	period **(In thousands, except percentages and per share amounts)**					
Net revenues	$ 26,098	$ 30,963	$ (4,865)	$ 44,072	$ 61,351	$ (17,279)
Gross profit	$ 9,761	$ 11,470	$ (1,709)	$ 14,636	$ 24,517	$ (9,881)
Gross margin percent	37.4%	37.0%	0.4 points	33.2%	40.0%	(6.8) points
Income (loss) from operations	$ 65	$ 1,339	$ (1,274)	$ (5,056)	$ 3,430	$ (8,486)
Net income (loss)	$ (167)	$ 1,100	$ (1,267)	$ (5,303)	$ 2,929	$ (8,232)
Net income (loss) per diluted share	$ (0.01)	$ 0.05	$ (0.06)	$ (0.24)	$ 0.13	$ (0.37)

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Net revenues for the second quarter of fiscal 2018 decreased compared to the same period in the prior year primarily due to lower equipment sales to PV manufacturers and lower Photonics product sales offset in part by higher equipment sales to HDD manufacturers and higher Photonics contract research and development (R&D). TFE recognized revenue on two 200 Lean® HDD systems in the second quarter of fiscal 2018. TFE recognized revenue on one 200 Lean HDD system, one pilot INTEVAC MATRIX® solar ion implant system and two ENERG*i*® solar ion implant systems in the second quarter of fiscal 2017. The Company reported a net loss for the second quarter of fiscal 2018 compared to net income for the second quarter of 2017 due to lower revenues, lower gross profit and increased spending on research and development, offset in part by lower selling, general and administrative expenses.

Net revenues for the first six months of fiscal 2018 decreased compared to the same period in the prior year primarily due to lower equipment sales to PV and cell phone manufacturers and lower Photonics product sales, offset in part by higher equipment sales to HDD manufacturers and higher Photonics contract R&D. TFE recognized revenue in the first half of fiscal 2018 on three 200 Lean HDD systems. TFE recognized revenue in the first half of fiscal 2017 on two 200 Lean HDD systems, one pilot INTEVAC MATRIX solar ion implant system, two ENERG*i* solar ion implant systems and four VERTEX® coating systems for DCP. The Company reported a net loss for the first half of fiscal 2018 compared to net income for the first half of fiscal 2017 due to lower revenues, lower gross profit and increased spending on research and development, offset in part by lower selling, general and administrative expenses.

Intevac expects that HDD equipment sales will be approximately at the same levels as 2017 as our HDD customers take delivery of fewer systems but more upgrades. In 2018, Intevac expects sales of new TFE products will be below the levels we achieved in 2017. We expect follow on orders for our VERTEX coating system for DCPs and we expect to recognize revenue on six of the twelve ENERG*i* implant systems that are currently in backlog. Photonics will continue to deliver production shipments of the night-vision camera modules for the F35 Joint Strike Fighter program in fiscal 2018. Deliveries under the multi-year Apache arrangement were completed in 2017. With the completion of the Apache program, our Photonics revenue profile is now moving from a product-driven one to a funded R&D revenue profile. For fiscal 2018, Intevac expects that Photonics revenues will be about 20% lower than fiscal 2017, and that Photonics profit will decrease compared to fiscal 2017 due to lower revenues and a higher mix of lower-margin contract R&D revenue.

Intevac s trademarks include the following: 200 Lean®, AccuLuber®, EBAPS®, ENERG*i*®, I-Port , LIVAR®, INTEVAC LSMA , INTEVAC MATRIX®, MicroVista®, NightVista®, Night Port®, oDLC and INTEVAC VERTEX® .

Results of Operations

Net revenues

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior period	June 30, 2018	July 1, 2017	Change over prior period
	(In thousands)					
TFE	$ 20,848	$ 22,426	$ (1,578)	$ 33,637	$ 43,910	$ (10,273)
Photonics:						
Products	2,487	7,437	(4,950)	5,170	14,376	(9,206)
Contract R&D	2,763	1,100	1,663	5,265	3,065	2,200

	5,250	8,537	(3,287)	10,435	17,441	(7,006)
Total net revenues	$ 26,098	$ 30,963	$ (4,865)	$ 44,072	$ 61,351	$ (17,279)

TFE revenue for the three and six months ended June 30, 2018 decreased compared to the same periods in the prior year as a result of lower sales of systems and spare parts, offset in part by higher sales of technology upgrades and service. TFE revenue for the three months ended June 30, 2018 included revenue recognized for two 200 Lean HDD systems. TFE revenue for the three months ended July 1, 2017 included revenue recognized for one 200 Lean HDD system, one pilot INTEVAC MATRIX solar ion implant system and two ENERG*i* solar ion implant systems. TFE recognized revenue in the first half of fiscal 2018 on three 200 Lean HDD systems. TFE recognized revenue in the first half of fiscal 2017 on two 200 Lean HDD systems, one pilot INTEVAC MATRIX solar ion implant system, two ENERG*i* solar ion implant systems and four VERTEX coating systems for DCP.

Photonics revenue for the three and six months ended June 30, 2018 decreased compared to the same periods in the prior year as a result of lower product sales revenues, offset in part by higher contract R&D work.

Backlog

	June 30, 2018	December 30, 2017	July 1, 2017
		(In thousands)	
TFE	$ 54,223	$ 51,719	$ 54,568
Photonics	10,344	12,302	14,380
Total backlog	$ 64,567	$ 64,021	$ 68,948

TFE backlog at June 30, 2018 includes three 200 Lean HDD systems and twelve ENERG*i* solar ion implant systems. Three of the twelve ENERG*i* systems have been delivered to the customer s fab but are subject to customer acceptance of certain contract terms. Installation of the three ENERG*i* systems began in July 2018. Delivery of the remaining nine tools is pending finalization with the customer. TFE backlog at December 30, 2017 included three 200 Lean HDD systems and twelve ENERG*i* solar ion implant systems. TFE backlog at July 1, 2017 included five 200 Lean HDD systems and twelve ENERG*i* solar ion implant systems.

Revenue by geographic region

	Three Months Ended June 30, 2018			Three Months Ended July 1, 2017		
			(In thousands)			
	TFE	Photonics	Total	TFE	Photonics	Total
United States	$ 1,351	$ 4,998	$ 6,349	$ 2,050	$ 8,333	$ 10,383
Asia	19,497	31	19,528	20,376	8	20,384
Europe		187	187		196	196
Rest of World		34	34			
Total net revenues	$ 20,848	$ 5,250	$ 26,098	$ 22,426	$ 8,537	$ 30,963

	Six Months Ended June 30, 2018			Six Months Ended July 1, 2017		
			(In thousands)			
	TFE	Photonics	Total	TFE	Photonics	Total
United States	$ 3,262	$ 9,760	$ 13,022	$ 2,663	$ 16,922	$ 19,585
Asia	30,375	31	30,406	41,247	8	41,255
Europe		480	480		511	511
Rest of World		164	164			
Total net revenues	$ 33,637	$ 10,435	$ 44,072	$ 43,910	$ 17,441	$ 61,351

International sales include products shipped to overseas operations of U.S. companies. The decrease in sales to the U.S. region in 2018 versus 2017 reflected lower Photonics product sales, offset in part by higher Photonics contract R&D work. Sales to the Asia region in 2018 included three 200 Lean HDD systems versus four VERTEX coating systems for DCP, two 200 Lean HDD systems and one pilot INTEVAC MATRIX solar ion implant system in 2017. Sales to the Europe region in 2018 and 2017 were not significant. Rest of World includes contract R&D for the Australian government as part of a program under the Department of Defense s Coalition Warfare Program which is funded by the U.S. government and several foreign nation coalition partners.

Gross profit

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior period	June 30, 2018	July 1, 2017	Change over prior period
	(In thousands, except percentages)					
TFE gross profit	$ 8,687	$ 8,618	$ 69	$ 13,242	$ 17,873	$ (4,631)
% of TFE net revenues	41.7%	38.4%		39.4%	40.7%	
Photonics gross profit	$ 1,074	$ 2,852	$ (1,778)	$ 1,394	$ 6,644	$ (5,250)
% of Photonics net revenues	20.4%	33.4%		13.4%	38.1%	
Total gross profit	$ 9,761	$ 11,470	$ (1,709)	$ 14,636	$ 24,517	$ (9,881)
% of net revenues	37.4%	37.0%		33.2%	40.0%	

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

TFE gross margin was 41.7% in the three months ended June 30, 2018 compared to 38.4% in the three months ended July 1, 2017 and was 39.4% in the six months ended June 30, 2018 compared to 40.7% in the six months ended July 1, 2017. The improvement in the gross margin percentage for the three months ended June 30, 2018 compared to the same period in the prior year was due primarily to a higher mix of higher-margin upgrades. The decrease in the gross margin percentage for the six months ended June 30, 2018 was due primarily to lower revenue. TFE gross margin for the three and six months ended July 1, 2017 reflects the lower margin on the pilot INTEVAC MATRIX solar ion implant system offset in part by the release of $2.2 million in previously-recognized inventory provisions upon the sale of two ENERG*i* solar ion implant systems. Gross margins in the TFE business will vary depending on a number of factors, including product mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

Photonics gross margin was 20.4% in the three months ended June 30, 2018 compared to 33.4% in the three months ended July 1, 2017 and was 13.4% in the six months ended June 30, 2018 compared to 38.1% in the six months ended July 1, 2017. The decline in gross margin for the three months ended June 30, 2018 was due to lower revenue levels and a higher mix of lower-margin contract R&D work. The lower gross margin for the six months ended June 30, 2018 was due to lower revenue levels, a higher mix of lower-margin contract R&D work and loss provisions taken on certain FFP contracts. Gross margins in the Photonics business will vary depending on a number of factors, including sensor yield, product mix, product cost, pricing, factory utilization, provisions for warranty and inventory reserves.

Research and development

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior period	June 30, 2018	July 1, 2017	Change over prior period
	(In thousands)					
Research and development expense	$ 4,984	$ 4,418	$ 566	$ 9,151	$ 9,100	$ 51

Research and development spending in TFE during the three and six months ended June 30, 2018 increased compared to the same periods in the prior year. TFE spending consisted primarily of semiconductor Fan-out packaging, DCP and PV development. TFE spending during the three and six months ended June 30, 2018 included charges of $666,000 related to the fixed asset disposal of certain lab equipment. Research and development spending decreased in Photonics during the three and six months ended June 30, 2018, as compared to the same periods in the prior year. Research and development expenses do not include costs of $2.5 million and $4.8 million for the three and six months ended June 30, 2018 respectively, or $1.1 million and $2.8 million for the three and six months ended July 1, 2017, respectively, which are related to customer-funded contract R&D programs in Photonics and therefore included in cost of net revenues.

Selling, general and administrative

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior period	June 30, 2018	July 1, 2017	Change over prior period
	(In thousands)					
Selling, general and administrative expense	$ 4,712	$ 5,713	$ (1,001)	$ 10,541	$ 11,987	$ (1,446)

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs. Selling, general and administrative expenses for the three and six months ended June 30, 2018 decreased compared to the same periods in the prior year primarily due to cost control initiatives implemented in the first quarter of fiscal 2018, lower variable compensation costs, lower legal expenses for patent applications and lower spending for strategic consulting.

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Cost reduction plans

During the first quarter of fiscal 2018, Intevac substantially completed implementation of the 2018 cost reduction plan (the Plan), which was intended to reduce expenses and reduce its workforce by 6 percent. The total cost of implementing the Plan was $95,000 of which $61,000 was reported under cost of net revenues and $34,000 was reported under operating expenses. Substantially all cash outlays in connection with the Plan were completed in the first quarter of fiscal 2018. Implementation of the Plan is expected to reduce salary, wages and other employee-related expenses by approximately $1.8 million on an annual basis.

Interest income and other income (expense), net

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior period	June 30, 2018	July 1, 2017	Change over prior period
			(In thousands)			
Interest income and other income (expense), net	$ 133	$ 127	$ 6	$ 278	$ 237	$ 41

Interest income and other income (expense), net is comprised of interest income, foreign currency gains and losses, and other income and expense, which includes earnout income from a divestiture.

Provision for income taxes

	Three months ended			Six months ended		
	June 30, 2018	July 1, 2017	Change over prior period	June 30, 2018	July 1, 2017	Change over prior period
			(In thousands)			
Provision for income taxes	$ 365	$ 366	$ (1)	$ 525	$ 738	$ (213)

Intevac recorded income tax provisions of $365,000 and $525,000 for the three and six months ended June 30, 2018, and $366,000 and $738,000 for the three and six months ended July 1, 2017. The income tax provisions for the three and six months are based upon estimates of annual income (loss), annual permanent differences and statutory tax rates in the various jurisdictions in which Intevac operates. For the three and six months ended June 30, 2018, Intevac utilized net operating loss carry-forwards to offset the impact of GILTI and recorded discrete items for withholding taxes on royalties paid to the United States from Intevac s Singapore subsidiary. For the three and six months ended July 1, 2017, Intevac utilized net operating loss carry-forwards to reduce taxable U.S. income to the AMT level and recorded discrete items for audit considerations in foreign jurisdictions and stock-based compensation excess tax benefits. 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 carry-forwards, availability of tax credits and the effectiveness of Intevac s tax planning strategies. Management carefully monitors these factors and timely adjusts the effective income tax rate.

Liquidity and Capital Resources

At June 30, 2018, Intevac had $39.1 million in cash, cash equivalents, restricted cash and investments compared to $43.5 million at December 30, 2017. During the first six months of 2018, cash, cash equivalents, restricted cash and investments decreased by $4.4 million due primarily to cash used by operating activities, purchases of fixed assets and tax payments related to the net share settlement of restricted stock units partially offset by cash received from the sale of Intevac common stock to Intevac s employees through Intevac s employee benefit plans.

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

	June 30, 2018	**December 30, 2017**
	(In thousands)	
Cash and cash equivalents	$ 13,731	$ 19,941
Restricted cash	1,000	1,000
Short-term investments	20,069	15,698
Long-term investments	4,279	6,849
Total cash, cash equivalents, restricted cash and investments	$ 39,079	$ 43,488

Operating activities used cash of $4.3 million during the first six months of 2018 and used cash of $4.0 million during the first six months of 2017. The increase in cash used by operations during the first six months of 2018 was primarily a result of the recognition of a net loss, offset in part by lower investments in working capital during the first six months of 2018.

Accounts receivable totaled $24.7 million at June 30, 2018 compared to $20.5 million at December 30, 2017. At June 30, 2018 customer advances for products that had not been shipped to customers and included in accounts receivable were $3.3 million. Net inventories totaled $33.0 million at June 30, 2018 compared to $33.8 million at December 30, 2017. Net inventories at both June 30, 2018 and December 30, 2017 include three ENERG*i* implant systems at a customer site for which installation procedures commenced in July 2018 and four ENERG*i* implant systems in work in process that are virtually complete, pending customer shipment. At June 30, 2018 net inventories include an additional three ENERG*i* implant systems in work in process that are partially built. Accounts payable totaled $5.2 million at June 30, 2018 compared to $3.9 million at December 30, 2017. Accrued payroll and related liabilities decreased to $4.8 million at June 30, 2018 compared to $6.8 million at December 30, 2017 due primarily to the settlement of 2017 bonuses. Other accrued liabilities increased to $10.5 million at June 30, 2018 compared to $7.7 million at December 30, 2017 primarily due to the recognition of the ASC 606 transition adjustment as well as incremental forward loss provisions recognized on certain Photonics R&D contracts. Customer advances decreased from $11.0 million at December 30, 2017 to $10.6 million at June 30, 2018, primarily due to the recognition of revenue, offset in part by the recognition of new orders.

Investing activities used cash of $3.1 million during the first six months of 2018. Purchases of investments net of proceeds from sales totaled $1.8 million. Capital expenditures for the six months ended June 30, 2018 were $1.4 million.

Financing activities provided cash of $1.3 million in the first six months of 2018. The sale of Intevac common stock to Intevac s employees through Intevac s employee benefit plans generated cash of $2.1 million. Tax payments related to the net share settlement of restricted stock units were $814,000.

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

As of June 30, 2018, approximately $7.4 million of cash and cash equivalents and $3.3 million of short term 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 subject to foreign withholding taxes.

Intevac believes that its existing cash, cash equivalents and investments will be sufficient to meet its cash requirements for the foreseeable future. Intevac intends to undertake approximately $4.0 million to $5.0 million in capital expenditures during the remainder of 2018.

Off-Balance Sheet Arrangements

Off-balance sheet firm commitments relating to outstanding letters of credit amounted to approximately $1.0 million as of June 30, 2018. These letters of credit and bank guarantees are collateralized by $1.0 million of restricted cash. We do not maintain any other off-balance sheet arrangements, transactions, obligations, or other relationships that would be expected to have a material current or future effect on the consolidated financial statements.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America (US GAAP) requires management to make judgments, assumptions and estimates that affect the amounts reported. Intevac s significant accounting policies are described in Note 1 to the consolidated financial statements included in Item 8 of Intevac s Annual Report on Form 10-K filed on February 14, 2018. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

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

Estimates and assumptions about future events and their effects cannot be determined with certainty. Intevac bases its estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as Intevac s operating environment changes. These changes have historically been minor and have been included in the consolidated financial statements as soon as they become known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. Many of these uncertainties are discussed in the section below entitled Risk Factors. Based on a critical assessment of Intevac s accounting policies and the underlying judgments and uncertainties affecting the application of those policies, management believes that Intevac s consolidated financial statements are fairly stated in accordance with US GAAP, and provide a meaningful presentation of Intevac s financial condition and results of operation.

Beginning December 31, 2017, we implemented ASC 606, Revenue from Contracts with Customers. For a description of our critical accounting policies and estimates affecting revenue recognition, see Note 2. Recent Accounting Pronouncements to our condensed consolidated financial statements included in this Quarterly Report on Form 10-Q. For a description of other critical accounting policies that affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements, refer to our Annual Report on Form 10-K for the year ended December 30, 2017 filed with the SEC on February 14, 2018. With the exception of the changes to our revenue recognition policies referenced above, there have been no material changes to our critical accounting policies during the during the six months ended June 30, 2018.

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

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

The table below presents principal amounts and related weighted-average interest rates by year of expected maturity for Intevac s investment portfolio at June 30, 2018.

	2018	2019	2020	Total	Fair Value
	(In thousands, except percentages)				
Cash equivalents					
Variable rate amounts	$ 5,168	$	$	$ 5,168	$ 5,168
Weighted-average rate	1.82%				
Short-term investments					

Fixed rate amounts	$ 11,562	$ 8,548	$	$ 20,110	$ 20,069
Weighted-average rate	1.84%	2.04%			
Long-term investments					
Fixed rate amounts	$	$ 2,707	$ 1,582	$ 4,289	$ 4,279
Weighted-average rate		2.09%	2.59%		
Total investment portfolio	$ 16,730	$ 11,255	$ 1,582	$ 29,567	$ 29,516

Foreign exchange risk. From time to time, Intevac enters into foreign currency forward exchange contracts to hedge certain of its anticipated foreign currency re-measurement exposures and to offset certain operational exposures from the impact of changes in foreign currency exchange rates. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on Intevac s operating results. The derivatives have original maturities of approximately 30 days. The notional amount of Intevac s foreign currency derivatives was $1.1 million at June 30, 2018 and $1.3 million at December 30, 2017.

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

Evaluation of disclosure controls and procedures

Intevac maintains a set of disclosure controls and procedures that are designed to ensure that information relating to Intevac required to be disclosed in periodic filings under the Securities Exchange Act of 1934, or Exchange Act, is recorded, processed, summarized and reported in a timely manner under the Exchange Act. In connection with the filing of this Form 10-Q for the quarter ended June 30, 2018, as required under Rule 13a-15(b) of the Exchange Act, an evaluation was carried out under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer (the CEO and CFO), of the effectiveness of Intevac s disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, Intevac s Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2018.

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

Definition of disclosure controls

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

Limitations on the effectiveness of controls

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

Changes in internal controls over financial reporting

Beginning December 31, 2017, we implemented ASC 606, Revenue from Contracts with Customers. Although the new revenue standard is expected to have an immaterial impact on our ongoing net income, we did implement changes to our processes related to revenue recognition and the control activities within them. These included the development of new policies based on the five-step model provided in the new revenue standard, ongoing contract review requirements, and gathering of information provided for disclosures.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

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

Item 1A. *Risk Factors*

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

The industries we serve are cyclical, volatile and unpredictable.

A significant portion of our revenue is derived from the sale of equipment used to manufacture commodity technology products such as disk drives, PV solar cells and cell phones. This subjects us to business cycles, the timing, length and volatility of which can be difficult to predict. When demand for commodity technology products exceeds production capacity, then demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of commodity technology products exceeds demand, then demand for new capital equipment such as ours tends to be depressed. For example, sales of systems for magnetic disk production were depressed from late 2007 through 2009. The number of new systems delivered increased in 2010 as customers increased their production capacity in response to increased demand for data storage, but decreased in 2011 through 2015 as the hard disk drive industry did not add the same level of capacity that it did in 2010. We cannot predict with any certainty when these cycles will begin or end. Our sales of systems for magnetic disk production increased modestly in 2016 as a customer began upgrading the technology level of its manufacturing capacity. 2017 sales of systems for magnetic disk production were higher than 2016 levels as this customer s technology upgrade continued.

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.

In recent years the photovoltaic (solar) market has undergone a downturn, which is likely to impact our sales of PV equipment. The solar industry from time to time experiences periods of structural imbalance between supply and demand, and such periods put intense pressure on our customers pricing. The solar industry is currently in such a period. Competition in solar markets globally and across the solar value chain is intense, and could remain that way for an extended period of time. During any such period, solar module manufacturers may reduce their sales prices in response to competition, even below their manufacturing costs, in order to generate sales and may do so for a sustained period of time. As a result, our customers may be unable to sell their solar modules or systems at attractive prices or for a profit during a period of excess supply of solar modules, which would adversely affect their results of operations and their ability to make capital investments such as purchasing our products.

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

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

We have no control over our customers upgrade and capacity expansion plans, and we cannot be sure they will select, or continue to select, our equipment when they upgrade or expand their capacity. The sales cycle for our equipment systems can be a year or longer, involving individuals from many different areas of Intevac and numerous product presentations and demonstrations for our prospective customers. Our sales process also commonly includes production of samples and customization of our products. We do not typically 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. In some cases orders are also subject to customer acceptance or other criteria even in the case of a binding agreement.

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.

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

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

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

In the market for our disk sputtering systems, we experience competition primarily from Canon Anelva, which has sold a substantial number of systems worldwide. In the 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 Harris Corporation and L-3 Communications. Some of our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do, especially in the DCP and PV equipment markets. Our competitors may develop enhancements to, or future generations of, competitive products that offer superior price or performance features, and new competitors may enter our markets and develop such enhanced products. Moreover, competition for our customers is intense, and our competitors have historically offered substantial pricing concessions and incentives to attract our customers or retain their existing customers.

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

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

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

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 or issues with a given customer. Orders from a relatively limited number of manufacturers have accounted for, and will likely continue to account for, a substantial portion of our revenues. The loss of one of these large customers, or delays in purchasing by them, could have a material and adverse effect on our revenues.

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

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

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

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

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

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

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

Comprehensive tax reform could adversely affect the company s business and financial condition.

Tax Reform was enacted on December 22, 2017 and significantly reforms the Internal Revenue Code of 1986, as amended. Tax Reform contains significant changes to corporate taxation, including reduction of the corporate tax rate from 35% to 21%, limitation of the tax deduction for interest expense to 30% of earnings, limitation of the deduction for net operating losses to 80% of current year taxable income and elimination of net operating loss carrybacks, one time taxation of offshore earnings at reduced rates regardless of whether they are repatriated, elimination of U.S. tax on foreign earnings (subject to certain important exceptions), immediate deductions for certain new investments instead of deductions for depreciation expense over time, and modifying or repealing many business deductions and credits. Notwithstanding the reduction in the corporate income tax rate, the overall impact of Tax Reform is uncertain, and the combined Company s business and financial condition could be adversely affected.

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

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

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

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

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

We have completed a number of acquisitions and dispositions during our operating history. Most recently, we completed the sale of certain semiconductor mainframe technology assets in 2012 and the sale of the assets of DeltaNu, LLC in 2013. 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 may be subject to additional impairment charges due to potential declines in the fair value of our assets.

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

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

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

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

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

We are a manufacturing business. Purchased parts constitute the largest component of our product cost. Our ability to manufacture depends on the timely delivery of parts, components and subassemblies from suppliers. We obtain some of the key components and subassemblies used in our products from a single supplier or a limited group of suppliers. If any of our suppliers fail to deliver quality parts on a timely basis, we may experience delays in manufacturing, which could result in delayed product deliveries, increased costs to expedite deliveries or develop alternative suppliers, or require redesign of our products to accommodate alternative suppliers. Some of our suppliers are thinly capitalized and may be vulnerable to failure.

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 and customer disputes. 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.

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 and incur substantial expenses to comply with them.

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.

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

A proxy contest with respect to election of our directors, or other activist stockholder activities, could adversely affect our business because: (1) responding to a proxy contest and other actions by activist stockholders can be costly and time-consuming, disruptive to our operations and divert the attention of management and our employees; (2) perceived uncertainties as to our future direction caused by activist activities may result in the loss of potential business opportunities, and may make it more difficult to attract and retain qualified personnel and business partners; and (3) if individuals are elected to our Board of Directors with a specific agenda, it may adversely affect our ability to effectively and timely implement our strategic plans.

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, our management must perform evaluations of our internal control over financial reporting. Beginning in 2004, our Form 10-K has included a report by management of their assessment of the adequacy of such internal control. Additionally, our independent registered public accounting firm must publicly attest to the effectiveness of our internal control over financial reporting. We have completed the evaluation of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Although our assessment, testing, and evaluation resulted in our conclusion that as of December 30, 2017, 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 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

On November 21, 2013, Intevac s Board of Directors approved a stock repurchase program authorizing up to $30.0 million in repurchases. At June 30, 2018, $1.5 million remains available for future stock repurchases under the repurchase program. Intevac did not make any common stock repurchases during the three months ended June 30, 2018.

Item 3. ***Defaults upon Senior Securities***

None.

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

Not applicable.

Item 5. ***Other Information***

None.

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Item 6. ***Exhibits***

The following exhibits are filed herewith:

Exhibit Number	Description
10.1	The Registrant s 2003 Employee Stock Purchase Plan, as amended February 14, 2018 (1)+
10.2	The Registrant s 2012 Equity Incentive Plan, as amended March 21, 2018 (1)+
31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Executive Vice President, Finance and Administration, Chief Financial Officer, Treasurer and Secretary Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications Pursuant to U.S.C. 1350 Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

(1) Previously filed as an exhibit in the Company s Definitive Proxy Statement filed April 11, 2018.

\+ Management compensatory plan or arrangement required to be filed as an exhibit.

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SIGNATURES

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

	INTEVAC, INC.
Date: July 31, 2018	By: /s/ WENDELL BLONIGAN Wendell Blonigan President and Chief Executive Officer (Principal Executive Officer)
Date: July 31, 2018	By: /s/ JAMES MONIZ James Moniz Executive Vice President, Finance and Administration, Chief Financial Officer and Treasurer (Principal Financial and Accounting Officer)