



INTEVAC

Annual Report

2007

## PROFILE

We are the world's leading provider of disk sputtering equipment to manufacturers of magnetic media used in hard disk drives and offer leading-edge, high productivity etch systems to the semiconductor industry. We also develop and market compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and the optical analysis of materials. We operate two segments: Equipment and Imaging.

Our hard disk deposition equipment business designs, manufactures, markets and services high productivity capital equipment which deposits, or sputters, highly engineered thin-films onto magnetic disks used in hard disk drives. We believe our disk sputtering systems represent approximately 60% of the installed capacity of disk sputtering systems worldwide. Our customers are manufacturers of magnetic disks for hard drives, and include Seagate Technology, Hitachi Global Storage Technologies and Fuji Electric. We believe the rapid growth of the storage of digital data, including new consumer applications such as DVRs and video recorders, emerging HDTV applications, streaming video and video game platforms; increasing enterprise data storage requirements; the proliferation of personal computers into emerging markets; along with new technology advances in the industry provide us with a significant opportunity to sell magnetic media manufacturing equipment.

Our semiconductor equipment business designs, manufactures, markets and services capital equipment for the dielectric etch market. Our Lean Etch™ system is capable of addressing the most difficult 300mm etch applications by providing enabling technology and twice the throughput of leading etch systems in the market.

Our Imaging business develops and manufactures sensors, cameras and systems for government applications such as digital night vision and long-range target identification and commercial applications in the inspection, medical, scientific and security industries. Our revenues are derived primarily from research and development contracts funded by the U.S. government and increasing levels of product sales in both government and commercial markets.

Our military products include sensors and cameras for use in extreme low-light situations, systems for long-range target identification, and high-performance micro-display products for near-eye and portable viewing of video.

Our commercial products include scientific cameras and Raman spectrometer systems. Our scientific cameras and systems provide previously unavailable high-sensitivity in the near-infrared portion of the light spectrum and are well suited for low-light spectroscopy, physical science, life science and industrial applications within the commercial imaging market. Our Raman spectrometer systems enable real-time, non-destructive identification of liquids and solids outside of the laboratory, and are well suited to applications such as hazmat, forensics, homeland security, geology, gemology, medical, pharmaceutical and industrial quality assurance.

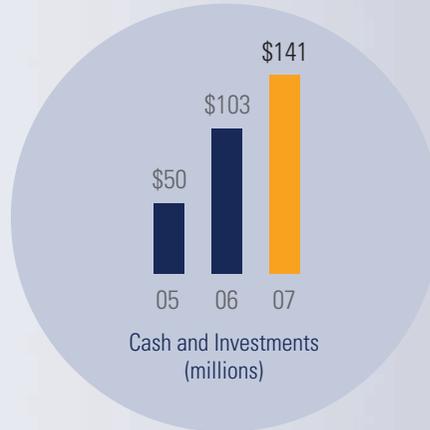
### FORWARD LOOKING STATEMENTS

The annual shareholder letter contains forward looking statements which involve risks and uncertainties. Words such as "believes", "expects", "anticipates" and the like indicate forward looking statements. These forward looking statements include comments related to our projected revenue, gross margin, operating expense, profitability, projected volatility in our financial results; projected customer requirements for new capacity and technology upgrades for our installed base of magnetic disk manufacturing equipment and when, and if, our customers will place orders for these products; demand for hard disk drives and memory, length of development, marketing and deployment cycles for our new products; Imaging Instrumentation's ability to proliferate its technology into major military weapons programs, develop and introduce commercial products and ability to successfully integrate acquisitions. Our actual results may differ materially from the results discussed in the forward looking statements for a variety of reasons, including those set forth under "Risk Factors" and should be read in conjunction with the Consolidated Financial Statements and related Notes contained elsewhere in this Annual Report on Form 10-K.

# Letter to our Shareholders

2007 was an exciting year for Intevac marked by several key growth initiatives. We successfully developed new products that will help us maintain our leadership in existing markets and diversify us into new markets. These products are the result of a combination of innovative and efficient product creation teams and a product development process that converts leading-edge technology into viable products that address the needs of our customers.

We ended the year with \$215.8 million in revenues and \$27.3 million in net income. One of the most significant achievements of 2007 was the gross margin improvement to 44.5% from 38.8% in 2006. We continue to make major strides in making our organization lean and efficient without impacting the development of new products, which is critical to our long term growth strategy.



FINANCIAL  
HIGHLIGHTS

## S U M M A R Y

The Equipment business experienced another successful year as we continued to strengthen our technology leadership in the hard disk drive market and position our products for customer adoption in the semiconductor market. Equipment revenues for 2007 were \$196.7 million and comprised twenty-nine 200 Lean® systems as well as disk lubrication systems, equipment upgrades, spares, consumables and service. We introduced two new products in 2007 with an objective to address our customers' technology and productivity needs – the Lean Etch™ and the AccuLuber™. We also made significant progress in developing a second-generation magnetic media deposition system – the 200 Lean® Gen II.

In July, we announced our new dielectric etch system, the Lean Etch, at SEMICON® West. The Lean Etch is our first system for the semiconductor equipment industry and targets the \$2 billion dielectric etch market. We are working closely with several leading memory device manufacturers in qualifying the Lean Etch by processing their wafers on our in-house application systems. We demonstrated significant advancements in dielectric etching that confirmed our system's competitive edge in chamber technology. Customer qualification has taken longer than we originally anticipated, as in mid-2007 our customers asked us to turn our focus towards their most advanced dielectric etch applications. This change in application focus resulted in design modifications to the process chamber and development of new process recipes in a new and unique process regime. Success at these leading-edge applications can mean a much larger, more sustainable market for the Lean Etch. Our product development efforts are now focused on further enhancing the Lean Etch process technology while continuing to improve its compelling cost proposition.

New products for the hard disk drive market defend our technology and market leadership position. The AccuLuber is the first disk lubrication system to utilize vapor process technology that ensures superior uniformity and also eliminates solvent and solvent related handling costs. We developed new sputter source concepts to enable future media technologies and improved our existing sputter sources to enable lower cost disk manufacturing. We extended the competitiveness of our market leading 200 Lean system with the next-generation Gen II system that features a 25% improvement in throughput (1000 dph), improved uptimes and reduced particulate contamination. Our developments continue to focus on media technology extendibility and reduced disk manufacturing costs to support our customers' business goals.

Equipment gross margins continued to improve in 2007, increasing to 44.7% from 39.1% in 2006, as a result of record high sales of upgrades and spares as well as reduced manufacturing costs. We have successfully ramped production at our Singapore facility, moved manufacturing closer to our customers, reduced cycle times and improved operational efficiency.



The 200 Lean magnetic media deposition system is used by disk media manufacturers worldwide and has an installed base of over 110 systems.



The AccuLuber is the first disk lubrication system with a unique vapor process capability that ensures superior uniformity and eliminates solvent and solvent related handling costs.



Launched at SEMICON West 2007, the Lean Etch system for dielectric etch is Intevac's first system for the semiconductor industry.

2007 was a defining year for our Imaging business. We achieved profitability in the second half of 2007 after many years in investment mode. We achieved record revenues and expanded our product portfolio through organic development and strategic acquisitions. Imaging revenues for 2007 were \$19.1 million and included \$13.9 million in research and development contracts and \$5.2 million in product sales. We accelerated our transition from a research and development contract centric business to a business that will be driven primarily by product sales. Product sales were up more than 200% over 2006.

Our Imaging business accomplished several major milestones this past year that are propelling our growth in product sales. We significantly ramped deliveries of our military, digital night vision camera to our NATO customer, as well as to a growing number of U.S. military customers. With our partner, DRS Technologies, we successfully delivered prototypes of the Digital-Enhanced Night Vision Goggle (DENVG) to the U.S. Army and are developing an enhanced design for delivery in 2008. This product “fuses” imagery from Intevac's digital night vision camera with imagery from DRS's thermal camera and displays it for the soldier in a near-eye micro-viewer. We achieved a steady increase both in commercial sales of our MOSIR® cameras used in scientific spectroscopy and imaging applications and DeltaNu Raman instrumentation products. We launched MicroVista®, a high-sensitivity, cost-effective camera for inspection, surveillance and scientific commercial markets that utilizes Intevac's unique capabilities in back-thinning CMOS wafers.

We completed two acquisitions strategic to our Imaging business in 2007. DeltaNu, a pioneer in compact Raman spectrometer systems, was acquired in January 2007 and has provided expansion of our lab-based and portable spectroscopy product offerings for the scientific, medical, and industrial markets. We have leveraged the synergies between the near-infrared sensor technology of our MOSIR camera and DeltaNu's Raman spectrometer product to introduce a new line of near-infrared Raman instruments for “fluorescence free” materials identification. In November 2007, we acquired Creative Display Systems (CDS), a company with specialized expertise in high-performance micro-display technology, whose products provide near-eye viewing of video in military, medical, and commercial markets. Creative Display Systems' expertise in integrated sensor/micro-display systems will be used to enhance the competitiveness of our head-mounted night vision systems for the large, multi-hundred million dollar military market that we are aggressively targeting.

We achieved significantly improved Imaging gross margins, which increased to 42.6% from 33.3% in 2006 as a result of higher factory utilization and an increased percentage of revenue derived from higher-margin product shipments.



Intevac manufactures sensors, cameras and systems for government applications such as digital night vision and long-range target identification for the defense industry and commercial applications in the inspection, medical, scientific and security markets.



Creative Display Systems offers high-performance, micro-display products for near-eye and portable viewing of video in defense, medical, training and simulation applications.



DeltaNu is a pioneer in compact Raman spectrometer systems for materials identification and analysis in scientific, medical and industrial applications.

## LOOKING AHEAD

We enter 2008 with a strong portfolio of new products that will further establish our leadership position in existing markets and position us to expand into new and larger markets. The focus in 2008 is to get these products qualified and established in the market and ramp revenues to achieve our growth goals.

We believe we are uniquely positioned in the capital equipment market by targeting both the hard disk drive and semiconductor memory markets. The world has an ever-increasing appetite for memory and this will in turn generate demand for our equipment. Several trends bode well for the future of the memory market. These include the increasing growth rate for laptops; proliferation of MP3 players and smart-phones; rapid rise in video streaming; conversion to hi-definition TVs and DVRs; digitization of photographs and video; web 2.0 initiatives that drive online storage and the economic emergence of developing nations. We believe that the proliferation of flash memory for consumer applications will not only increase demand for hard disk drives as low cost back-up storage but will also propel the use of hybrid flash hard drives for more storage intensive applications.

Given the current economic climate coming into 2008, we expect hard disk drive manufacturers to make prudent and conservative capital spending and capacity decisions. We believe our operational model enables us to offer the shortest lead times in the industry, positioning us favorably to customers who need to react quickly to changing market dynamics. The Gen II upgrade package for the installed base of over one hundred and ten 200 Leans is designed to help customers meet areal density requirements and rapidly expand capacity without investing in additional facilities. This makes the Gen II upgrade package a technologically advanced and economically attractive option that we believe will be welcomed by both new and existing customers in 2008.

The current semiconductor equipment market is challenged as a result of falling chip prices and delayed fab expansions. We see this situation as an opportunity. Customers must continue to lower their cost of manufacturing, which is exactly what the Lean Etch is designed to accomplish. The slower market in 2008 gives us time to get qualified before the market moves back into investment mode in 2009.

We expect 2008 to be another year of strong growth for our Imaging business as we continue executing our plan to transition the business toward greater product based revenue. At least 50% of our revenue in 2008 is expected from product sales, nearly double the 2007 level. Providing our customers in both government and commercial markets with enabling sensor, camera and system products produced from world-class volume manufacturing methods remains critical to strengthening our competitive position and driving our financial growth.

In our government business, we expect to deliver greater than 1,000 night vision cameras and camera modules based on our digital sensor to various U.S. and international military customers. We remain committed to developing our core sensor technology and, with government funding, we are on track to introduce an enhanced-performance, next-generation night vision sensor in 2008, which we believe will be instrumental in transitioning head-mounted night vision systems to the digital age. Our collaboration with DRS Technologies on the Digital-Enhanced Night Vision Goggle (DENVG) will continue and we expect to field test an enhanced version, based on next-generation night vision and thermal sensors from Intevac and DRS, in late 2008. We anticipate the U.S. Army will fund DENVG pre-production in 2009, followed by a production order valued at over \$150 million in 2011. To strengthen our position to win these contracts, we will integrate our new acquisition, Creative Display Systems (CDS), in this area in 2008. CDS's expertise in integrated micro-display sensor systems for near-eye, video viewing enhances our capabilities to be a critical goggle systems supplier in the large head-mounted, digital-vision military market. We also expect to see revenue growth from our LIVAR® camera products in 2008. Our next-generation LIVAR camera will be delivered in pre-production quantities for both ground-based and airborne applications, and we expect to begin delivering initial production quantities during the later part of the year.

In our commercial Imaging business, we expect continued growth in sales from our MOSIR and MicroVista camera products and from our DeltaNu family of Raman instruments. Our growth will be achieved through increased market share in our traditional scientific markets, as well as through penetration into new market areas involving inspection, medical diagnostic and security applications. In particular, we are pursuing product opportunities in these markets with our DeltaNu hand-held Raman instrument, which is expected to generate product sales in 2008. In addition, we expect to expand our CDS micro-display system products into commercial areas involving medical, veterinarian, training and simulation applications.

The year ahead holds many opportunities for us and we are in a stronger position than ever to leverage these opportunities. Our diligent focus on innovation coupled with intense efforts to create a leaner, more efficient organization positions us for ongoing profitable growth.

I would like to express my sincere appreciation and thanks to all our employees for their commitment, hard work and creativity, as well as to our customers and shareholders for their continuing support.



*Kevin Fairbairn*

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Kevin Fairbairn  
President and  
Chief Executive Officer

## Corporate Information

**CORPORATE HEADQUARTERS**  
3560 Bassett Street  
Santa Clara, CA 95054-2704  
(408) 986-9888

**INVESTOR INFORMATION**  
The Company's Annual Report, its 10-K and 10-Q reports to the SEC, and other information about Intevac, Inc. are available at [www.intevac.com](http://www.intevac.com) or by e-mail to [jdliener@intevac.com](mailto:jdliener@intevac.com).

**INVESTOR RELATIONS CONTACT**  
JEFFREY S. ANDRESON  
(408) 986-9888

**REGISTRAR AND TRANSFER AGENT**  
COMPUTERSHARE TRUST COMPANY, N.A.  
P.O. Box 43078  
Providence, RI 02940-3078  
[www.computershare.com](http://www.computershare.com)

**INDEPENDENT AUDITORS**  
GRANT THORNTON LLP  
150 Almaden Blvd.  
Suite 600  
San Jose, CA 95113

**GENERAL COUNSEL**  
WILSON SONSINI GOODRICH & ROSATI  
650 Page Mill Road  
Palo Alto, CA 94304-1050

**COMMON STOCK**  
The Company's Common Stock trades on the NASDAQ National Market<sup>®</sup> tier of the NASDAQ Stock Market<sup>®</sup> under the symbol IVAC.

**STOCK PRICE HISTORY**  
Closing prices for the quarter ended:

	3/31/07	6/30/07	9/29/07	12/31/07
High	\$ 30.57	\$ 26.77	\$ 22.37	\$ 18.12
Low	\$ 22.00	\$ 18.92	\$ 13.23	\$ 14.01

**DIVIDENDS**  
The Company does not currently anticipate paying any cash dividends.

**ANNUAL MEETING OF SHAREHOLDERS**  
The annual meeting of shareholders will be held at the Company's offices at 4:30p.m. PDT on Thursday May 15, 2008.

## Corporate Officers

VERLE W. AEBI (1991)  
Chief Technology Officer,  
Imaging Instrumentation

JEFFREY S. ANDRESON (2007)  
Vice President, Finance and Administration,  
Chief Financial Officer, Treasurer and Secretary

MICHAEL S. BARNES (2006)  
Vice President and Chief Technical Officer

JAMES P. BIRT (2004)  
Vice President, Customer Support,  
Equipment Products

TERRY M. BLUCK (2004)  
Vice President, Technology,  
Equipment Products

KIMBERLY M. BURK (2000)  
Managing Director, Human Resources

KEITH CARRON (2007)  
Managing Director and General Manager,  
DeltaNu

JEROME T. CAROLLO (2007)  
Vice President and General Manager,  
Creative Display Systems

KEVIN P. FAIRBAIRN (2002)  
President and Chief Executive Officer

TIMOTHY E. JUSTYN (1991)  
Vice President, Manufacturing,  
Equipment Products

DAVID L. KELLY (2006)  
Vice President, Engineering,  
Imaging Instrumentation

RALPH C. KERNS (2003)  
Vice President, Business Development,  
Equipment Products

LUKE A. MARUSIAK (2004)  
Chief Operating Officer

JOSEPH S. PIETRAS (2006)  
Vice President and General Manager,  
Imaging Instrumentation

NORMAN H. POND (1990)  
Chairman of the Board

( ) INDICATES YEAR JOINED INTEVAC

## Board of Directors

DAVID S. DURY (2002)<sup>1,4</sup>  
Co-Founder,  
Mentor Capital Group LLC

KEVIN P. FAIRBAIRN (2002)  
President and Chief Executive Officer

STANLEY J. HILL (2004)<sup>1,3</sup>  
Former Chairman and Chief Executive Officer,  
Kaiser Aerospace & Electronics Corporation

ROBERT A. LEMOS (2002)<sup>1,2</sup>  
Former Chief Financial Officer,  
Varian Associates

NORMAN H. POND (1990)  
Chairman of the Board

PING YANG (2006)<sup>2,3</sup>  
Former Vice President, Research and Development,  
Taiwan Semiconductor Manufacturing Company  
(TSMC)

<sup>1</sup> MEMBER OF THE AUDIT COMMITTEE

<sup>2</sup> MEMBER OF THE COMPENSATION COMMITTEE

<sup>3</sup> MEMBER OF THE NOMINATING AND GOVERNANCE COMMITTEE

<sup>4</sup> LEAD INDEPENDENT DIRECTOR

( ) INDICATES YEAR JOINED BOARD OF DIRECTORS



# INTEVAC

Intevac, Inc.  
3560 Bassett Street  
Santa Clara, CA 95054  
Phone: (408) 986-9888  
Fax: (408) 988-8145  
[www.intevac.com](http://www.intevac.com)

Intevac Asia Pte., Ltd.  
6, Marsiling Lane  
Block C # 01-00  
Singapore 739145  
Phone: 65-6368-6863  
Fax: 65-6368-5601

Intevac Shenzhen Co. Ltd.  
P.O. Box 40, Shen Fu Bao Building  
Suite 1708-1710, Shen Fu Bao Building  
128 Rong Hua Road, Futian Free Trade Zone  
Shenzhen, Guangdong, P.R. China 518038  
Phone: 86-755-8348-4020  
Fax: 86-755-8348-4035

Intevac Japan K. K.  
Takuei Yokohama Nishiguchi Bldg. 6F  
3-30-5 Tsuruya-cho Kanagawa-ku Yokohama  
Kanagawa Japan 221-0835  
Phone: 81-45-317-3455  
Fax: 81-45-312-3535

Intevac Malaysia Sdn. Bhd.  
Suite 10 & 11, First Floor,  
Techno Centre, Kulim Hi-Tech Park,  
09000 Kulim, Kedah Darul Aman, Malaysia  
Phone: 60-4-403-7880  
Fax: 60-4-403-4882

IVAC Co., Ltd.  
#10-02 Owners Towers, 16-5 Sunae-dong  
Bundang-gu Seongnam-si Gyeonggi-do,  
463-835 South Korea  
Phone: 82-31-713-5055  
Fax: 82-31-713-2377

DeltaNu Inc.  
628 Plaza Lane  
Laramie, WY 82070  
Phone: (307) 745-9148  
Fax: (307) 745-9152

Creative Display Systems  
5909 Sea Lion Place, Ste. A  
Carlsbad, CA 92010  
Phone: (760) 476-0339  
Fax: (760) 476-0620

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