INTEVAC INC

FORM 10-Q
(Quarterly Report)

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Address	3560 BASSETT STREET SANTA CLARA, CA, 95054
Telephone	4089869888
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Industry	Industrial Machinery & Equipment
Sector	Industrials
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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 26, 2004

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)

California	**94-3125814**
(State or other jurisdiction of incorporation or organization)	*(IRS Employer Identification No.)*

3560 Bassett Street
Santa Clara, California 95054
(Address of principal executive office, including Zip Code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ☑ No ☐

APPLICABLE ONLY TO CORPORATE ISSUERS:

On June 26, 2004, 20,038,814 shares of the Registrant’s Common Stock, no par value, were outstanding.

INTEVAC, INC.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

INTEVAC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands)

	June 26, 2004	December 31, 2003
	(Unaudited)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 21,880	$ 19,507
Short term investments	15,632	—
Trade and other accounts receivable, net of allowances of $24 and $22 at June 26, 2004 and December 31, 2003	15,597	14,016
Inventories	38,907	13,108
Prepaid expenses and other current assets	737	1,113
Total current assets	92,753	47,774
Property, plant and equipment, net	5,848	5,796
Long term investments	12,187	—
Investment in 601 California Avenue LLC	2,431	2,431
Other long term assets	3	4
Total assets	$113,222	$ 55,975
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Convertible notes	$ —	$ 1,025
Accounts payable	7,222	3,396
Accrued payroll and related liabilities	1,687	1,610
Other accrued liabilities	3,134	2,643
Customer advances	30,635	16,432
Total current liabilities	42,678	25,106
Shareholders' equity:		
Common stock, no par value	94,189	51,982
Accumulated other comprehensive income	216	223
Accumulated deficit	(23,861)	(21,336)
Total shareholders' equity	70,544	30,869
Total liabilities and shareholders' equity	$113,222	$ 55,975

See accompanying notes.

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands, except per share amounts) (Unaudited)			
Net revenues:				
Systems and components	$15,626	$ 2,677	$19,819	$13,241
Technology development	2,354	1,910	4,660	3,361
Total net revenues	17,980	4,587	24,479	16,602
Cost of net revenues:				
Systems and components	10,348	1,711	12,949	11,032
Technology development	1,654	1,435	3,321	2,559
Inventory provisions	187	322	753	732
Total cost of net revenues	12,189	3,468	17,023	14,323
Gross profit	5,791	1,119	7,456	2,279
Operating expenses:				
Research and development	3,083	3,114	6,141	5,743
Selling, general and administrative	2,223	2,146	4,393	4,071
Total operating expenses	5,306	5,260	10,534	9,814
Operating profit (loss)	485	(4,141)	(3,078)	(7,535)
Interest expense	—	(508)	(12)	(1,025)
Interest income and other, net	307	(148)	553	(243)
Income (loss) before income taxes	792	(4,797)	(2,537)	(8,803)
Benefit from income taxes	—	—	(12)	—
Net income (loss)	$ 792	$ (4,797)	(2,525)	$ (8,803)
Other comprehensive income:				
Foreign currency translation adjustments	(11)	10	(7)	4
Total comprehensive income (loss)	$ 781	$ (4,787)	$ (2,532)	$ (8,799)
Basic income (loss) per share:				
Net income (loss)	$ 0.04	$ (0.39)	$ (0.13)	$ (0.72)
Shares used in per share amounts	20,010	12,187	19,373	12,176
Diluted income (loss) per share:				
Net income (loss)	$ 0.04	$ (0.39)	$ (0.13)	$ (0.72)
Shares used in per share amounts	20,678	12,187	19,373	12,176

See accompanying notes.

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended	
	June 26, 2004	June 28, 2003
	(In thousands) (Unaudited)	
Operating activities		
Net loss	$ (2,525)	$ (8,803)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	1,131	950
Inventory provisions	753	732
Loss on disposal of equipment	1	642
Changes in operating assets and liabilities	(9,150)	(234)
Total adjustments	(7,265)	2,090
Net cash and cash equivalents used in operating activities	(9,790)	(6,713)
Investing activities		
Purchases of investments	(27,895)	—
Purchases of leasehold improvements and equipment	(1,108)	(1,680)
Net cash and cash equivalents used in investing activities	(29,003)	(1,680)
Financing activities		
Proceeds from issuance of common stock	42,207	186
Payoff of convertible notes due 2004	(1,025)	—
Net cash and cash equivalents provided by financing activities	41,182	186
Effect of exchange rate changes on cash	(16)	(7)
Net increase (decrease) in cash and cash equivalents	2,373	(8,214)
Cash and cash equivalents at beginning of period	19,507	28,457
Cash and cash equivalents at end of period	$ 21,880	$20,243
Supplemental Schedule of Cash Flow Information		
Cash paid (received) for:		
Interest	$ 33	$ 993
Income tax refund	$ —	$ (214)

See accompanying notes.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Business Activities and Basis of Presentation

We are the world's leading provider of thin-film disk sputtering equipment for the thin-film disk industry and a developer of leading technology for extreme low light imaging sensors, cameras and systems. We operate two businesses: Equipment and Imaging.

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

Our Imaging business develops and manufactures electro-optical sensors, cameras, and systems that permit highly sensitive detection of photons in the visible and near infrared portions of the spectrum, allowing imaging in extreme low light situations. These efforts are aimed at creating new products for both military and commercial applications.

The financial information at June 26, 2004 and for the three- and six-month periods ended June 26, 2004 and June 28, 2003 is unaudited, but includes all adjustments (consisting only of normal recurring accruals) that we consider necessary for a fair presentation of the financial information set forth herein, in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, it does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2003.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements. Our critical accounting policies are summarized in Item 2 of this Form 10-Q.

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

The results for the three- and six-month periods ended June 26, 2004 are not considered indicative of the results to be expected for any future period or for the entire year.

2. Concentrations

Our largest customers tend to change from period to period. Historically, a significant portion of our revenues in any particular period have been attributable to sales to a limited number of customers. Our order backlog at June 26, 2004 included orders for nine 200 Lean systems from one customer.

3. Inventories

Inventories are priced using standard costs, which approximate first-in, first-out. The components of inventory consist of the following:

	June 26, 2004	December 31, 2003
	(In thousands)	
Raw materials	$ 8,044	$ 3,306
Work-in-progress	2,577	4,371
Finished goods	28,286	5,431
	$38,907	$13,108

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

Inventory reserves included in the above numbers were $10.8 million and $10.2 million at June 26, 2004 and December 31, 2003, respectively. Each quarter, we analyze our inventory (raw materials, work-in-progress and finished goods) against the forecast demand for the next 12 months. Parts with no forecast requirements in that period are considered excess and inventory provisions are established to write those parts down to zero net book value. During this process, some inventory is identified as having no future use or value to us and is disposed of against the reserves. During the six months ended June 26, 2004, $753,000 was added to inventory reserves based on the quarterly analysis and $261,000 of inventory was disposed of and charged to the reserve. During the six months ended June 28, 2003, $732,000 was added to inventory reserves based on the quarterly analysis and $4,000 of inventory was disposed of and charged to the reserve.

3. Employee Stock Plans

At June 26, 2004, we had two stock-based employee compensation plans. We account for those plans under the recognition and measurement principles of APB Opinion No. 25, “Accounting for Stock Issued to Employees”, and related Interpretations. No stock-based employee compensation cost is reflected in net income, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. We do not plan to adopt the fair value requirements of SFAS 123 for reporting purposes, unless it is mandated by GAAP.

The following table illustrates the effects on net income and earnings per share if Intevac had applied the fair value-recognition provisions of FASB Statement No. 123, “Accounting for Stock-Based Compensation”, to stock-based employee compensation.

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands)			
Net income (loss), as reported	$ 792	$(4,797)	$(2,525)	$(8,803)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(341)	(155)	(609)	(267)
Pro forma net income (loss)	$ 451	$(4,952)	$(3,134)	$(9,070)
Basic and diluted loss per share:				
As reported	$0.04	$ (0.39)	$ (0.13)	$ (0.72)
Pro forma	$0.02	$ (0.41)	$ (0.16)	$ (0.74)

4. Warranty

Our typical warranty is 12 months from customer acceptance. In some cases we market extended warranty periods beyond 12 months to our customers. The warranty period on used systems is generally shorter than 12 months. During this warranty period any necessary non-consumable parts are supplied and installed. The warranty period on consumable parts is limited to their reasonable usable life. A provision for the estimated warranty cost is recorded at the time revenue is recognized.

The following table displays the activity in the warranty provision account, which is included in other accrued liabilities on our balance sheet, for the three and six-month periods ending June 26, 2004 and June 28, 2003:

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands)			
Beginning balance	$ 386	$644	$ 534	$ 845
Expenditures incurred under warranties	(53)	(46)	(109)	(607)
Accruals for product warranties issued during the reporting period	456	32	493	191
Adjustments to previously existing warranty accruals	(105)	34	(234)	235
Ending balance	$ 684	$664	$ 684	$ 664

5. Guarantees

We have entered into agreements with customers and suppliers that include limited intellectual property indemnification obligations that are customary in the industry. These guarantees generally require us to compensate the other party for certain damages and costs incurred as a result of third party intellectual property claims arising from these transactions. The nature of the intellectual property indemnification obligations prevents us from making a reasonable estimate of the maximum potential amount we could be required to pay our customers and suppliers. Historically, we have not made any significant indemnification payments under such agreements and no amount has been accrued in the accompanying consolidated financial statements with respect to these indemnification obligations.

6. Cash, Cash Equivalents and Investments in Debt Securities

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

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

In accordance with Statement of Accounting Standards No. 115 "Accounting for Certain Investments in Debt and Equity Securities," and based on our intentions regarding these instruments, we have classified our investments in debt securities as held-to-maturity and account for these investments at amortized cost. Interest income is recorded using an effective interest rate, with the associated premium or discount amortized to interest income. Realized gains and losses are included in earnings. The table below presents the amortized principal amount, major security type and maturities for our investments in debt securities. The amortized principal amount approximates fair value at June 26, 2004.

	June 26, 2004	December 31, 2003
	(In thousands)	
Amortized Principal Amount:		
Debt securities issued by US government agencies	$22,096	$—
Corporate debt securities	5,723	—
Total investments in debt securities	$27,819	$—
Short-term investments	$15,632	$—
Long-term investments	12,187	—
Total investments in debt securities	$27,819	$—

7. Net Income (Loss) Per Share

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

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands)			
Numerator:				
Numerator for basic income (loss) per share — loss available to common stockholders	$ 792	$ (4,797)	$ (2,525)	$ (8,803)
Effect of dilutive securities:				
6 1/2% convertible notes(1)	—	—	—	—
Numerator for diluted income (loss) per share — loss available to common stockholders after assumed conversions	$ 792	$ (4,797)	$ (2,525)	$ (8,803)
Denominator:				
Denominator for basic income (loss) per share — weighted-average shares	20,010	12,187	19,373	12,176
Effect of dilutive securities:				
Employee stock options(2)	668	—	—	—
6 1/2% convertible notes(1)	—	—	—	—
Dilutive potential common shares	668	—	—	—
Denominator for diluted income (loss) per share — adjusted	20,678	12,187	19,373	12,164

(1) Diluted EPS for the three- and six-month periods ended June 26, 2004 and June 28, 2003 exclude "as converted" treatment of the convertible notes, as their inclusion would be anti-dilutive. The number of

"as converted" shares excluded for the six-month period ended June 26, 2004 was 17,137 and the number of "as converted" shares excluded for the three- and six-month periods ended June 28, 2003 was 4,269,983.

(2) Potentially dilutive securities, consisting of shares issuable upon exercise of employee stock options, are excluded from the calculation of diluted EPS as their effect would be anti-dilutive. The weighted average number of employee stock options excluded for the three-month periods ended June 26, 2004 and June 28, 2003 was 247,102 and 1,793,950, respectively, and the number of employee stock options excluded for the six-month periods ended June 26, 2004 and June 28, 2003 was 1,486,205 and 1,792,059, respectively.

8. Segment Reporting

Segment Description

We have two reportable operating segments: Equipment and Imaging. Our Equipment business designs, manufactures, markets and services complex capital equipment used in the sputtering, or deposition, of highly engineered thin films of material onto thin-film disks which are used in hard disk drives. Our Imaging business develops and manufactures electro-optical sensors, cameras and systems that permit highly sensitive detection of photons in the visible and near infrared portions of the spectrum, allowing imaging in extreme low light situations.

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

Business Segment Net Revenues

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands)			
Equipment	$15,403	$2,396	$19,556	$12,813
Imaging	2,577	2,191	4,923	3,789
Total	$17,980	$4,587	$24,479	$16,602

Business Segment Profit & Loss

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands)			
Equipment	$1,415	$(1,937)	$ (803)	$(3,157)
Imaging	(726)	(1,394)	(1,551)	(3,021)
Corporate activities	(204)	(810)	(724)	(1,357)
Operating income (loss)	485	(4,141)	(3,078)	(7,535)
Interest expense	—	(508)	(12)	(1,025)
Interest income	148	88	232	165
Other income and expense, net	159	(236)	321	(408)
Income (loss) before income taxes	$ 792	$(4,797)	$(2,537)	$(8,803)

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS — (Continued)

Business Segment Assets

	June 26, 2004	December 31, 2003
	(In thousands)	
Equipment	$ 53,159	$25,462
Imaging	7,279	7,702
Corporate activities	52,784	22,811
Total	$113,222	$55,975

Geographic Area Net Trade Revenues

	Three Months Ended		Six Months Ended	
	June 26, 2004	June 28, 2003	June 26, 2004	June 28, 2003
	(In thousands)			
United States	$11,155	$2,521	$14,015	$ 4,608
Far East	6,454	2,060	10,093	11,988
Europe	371	—	371	—
Rest of World	—	6	—	6
Total	$17,980	$4,587	$24,479	$16,602

9. Income Taxes

We did not accrue a tax provision for the three-month period ended June 26, 2004 as the profits for this period were offset by net operating loss carry-forwards. We did not accrue a tax benefit for either the six-month period ended June 26, 2004 or the three- and six-month periods ended June 28, 2003, due to the inability to realize additional refunds from loss carry-backs. The $12,000 credit to income tax expense during the six-month period ended June 26, 2004 related to a revised estimate of 2003 taxes owed by our Singapore subsidiary. Our $17.6 million deferred tax asset is fully offset by a $17.6 million valuation allowance, resulting in a net deferred tax asset of zero at June 26, 2004.

10. Capital Transactions

During the six-month period ending June 26, 2004, we completed a public offering of 4,750,000 shares of our common stock, of which 2,969,000 were newly issued and outstanding shares sold by us for net proceeds of $41.6 million. A selling shareholder sold 1,781,000 shares in the offering. We also sold stock to our employees under Intevac’s Stock Option and Employee Stock Purchase Plans. A total of 116,350 shares were issued under these plans during the six-month period ending June 26, 2004, for which Intevac received $647,000.

11. Financial Presentation

Certain prior year amounts in the Condensed Consolidated Financial Statements have been reclassified to conform to 2004 presentation.

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

This Quarterly Report on Form 10-Q contains forward-looking statements which involve risks and uncertainties. Words such as "believes," "expects," "anticipates" and the like indicate forward-looking statements. These forward looking statements include comments related to our shipments, projected revenue, system revenue recognition, gross margin, interest income, cash balances and improved financial results in 2004; our projected customer requirements for new capacity and technology upgrades for our installed base of thin-film disk manufacturing equipment, and when, and if, our customers will place orders for these products; Imaging's ability to proliferate its technology into major military weapons programs and to develop and introduce commercial imaging products; and the timing of delivery and/or acceptance of the systems and products that comprise our backlog for revenue. Our actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under "Certain Factors Which May Affect Future Operating Results" and in other documents we file from time to time with the Securities and Exchange Commission, including Intevac's Annual Report on Form 10-K filed in March 2004, Form 10-Q's and Form 8-K's.

Critical Accounting Policies and Estimates

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America ("US GAAP") requires management to make judgments, assumptions and estimates that affect the amounts reported. Our significant accounting policies are described in Note 2 to the consolidated financial statements included in Item 8 of our Annual Report on Form 10-K. Certain of these significant accounting policies are considered to be critical accounting policies, as defined below.

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

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

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

Revenue Recognition

Certain of our system sales with customer acceptance provisions are accounted for as multiple-element arrangements. If we have previously met defined customer acceptance levels with the specific type of system, then we recognize revenue for the fair market value of the system upon shipment and transfer of title, and recognize revenue for the fair market value of installation and acceptance services when those services are completed. We estimate the fair market value of the installation and acceptance services based on our actual historical experience. For systems that have generally not been demonstrated to meet product specifications prior to shipment, revenue recognition is typically deferred until customer acceptance. For example, our legacy MDP-250B system is recognized for revenue on shipment, while our new 200 Lean system currently is not recognized for revenue until customer acceptance.

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

Inventories

Inventories are priced using standard costs, which approximate first-in, first-out, and are generally stated at the lower of cost or market. The carrying value of inventory is reduced for estimated excess and obsolescence by the difference between its cost and the estimated market value based on assumptions about future demand. We evaluate the inventory carrying value for potential excess and obsolete inventory exposures by analyzing historical and anticipated demand. In addition, inventories are evaluated for potential obsolescence due to the effect of known and anticipated engineering change orders and new products. If actual demand were to be substantially lower than estimated, additional inventory adjustments would be required, which could have a material adverse effect on our business, financial condition and results of operation.

Warranty

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

Results of Operations

Three Months Ended June 26, 2004 and June 28, 2003.

Net revenues. Net revenues consist primarily of sales of equipment used to manufacture thin-film disks, equipment used to manufacture flat panel displays, related equipment and system components, and contract research and development related to the development of electro-optical devices and systems. Net revenues increased 292% to $18.0 million for the three months ended June 26, 2004 from $4.6 million for the three months ended June 28, 2003.

Equipment revenues increased to $15.4 million for the three months ended June 26, 2004 from $2.4 million for the three months ended June 28, 2003. The increase in Equipment revenue was the result of customer acceptance of two 200 Lean systems for revenue, the sale of one MDP-250B system and higher revenue from disk equipment technology upgrades and spare parts in the three months ending June 26, 2004. We currently have orders for nine 200 Lean systems, all of which have been shipped, and for one MDP-250B system. We expect to recognize revenue on these systems during the second half of 2004. Before recognizing revenue on a new system, such as the 200 Lean, our policy requires that the system be delivered, pass rigorous acceptance testing and be accepted without contingency by the customer. Additionally, any remaining amounts due by the customer for that system must be scheduled for payment. Accordingly, the timing of revenue recognition for these systems in any quarter can be difficult to predict, and projected revenues and profits in any period may vary widely and be materially different from expectations, depending on the number of systems that we actually recognize for revenue.

Imaging revenues increased to $2.6 million for the three months ended June 26, 2004 from $2.2 million for the three months ended June 28, 2003. The increase in Imaging revenues was the result of increased revenues from contract research and development. We expect Imaging revenues to grow on a year over year basis in 2004.

Our backlog of orders at June 26, 2004 was $46.4 million, as compared to a June 28, 2003 backlog of $14.3 million. The increase in backlog was primarily the result of orders for disk manufacturing systems and upgrades, and to a lesser extent, orders for contract research and development in the Imaging business. We include in backlog the value of purchase orders for our products that have been shipped but not accepted or have scheduled delivery dates. We do not recognize revenue on this backlog until we have met the criteria contained in our revenue recognition policy, including customer acceptance of new systems.

International sales increased by 230% to $6.8 million for the three months ended June 26, 2004 from $2.1 million for the three months ended June 28, 2003. The increase in international sales was due to higher shipments of disk equipment technology upgrades and spare parts. International sales constituted 38% of net revenues for the three months ended June 26, 2004 and 45% of net revenues for the three months ended June 28, 2003. International revenues include products shipped to overseas operations of US companies.

Gross margin. Cost of net revenues consists primarily of purchased materials and costs attributable to contract research and development, and also includes fabrication, assembly, test and installation labor and overhead, customer-specific engineering costs, warranty costs, royalties, provisions for inventory reserves and scrap. Gross margin increased to 32.2% for the three months ended June 26, 2004 from 24.4% for the three months June 28, 2003.

Gross margin in Equipment increased to 34.3% for the three-month period ended June 26, 2004 from 26.8% for the three-month period ended June 28, 2003. The increase in Equipment margin was due to the increase in revenue from disk equipment technology upgrades and spare parts and the sale of two 200 Lean systems. Gross margin for the three months ended June 26, 2004 was adversely impacted, however, by higher than anticipated production and installation costs for the 200 Lean and by costs for scrap, rework and actual and expected obsolescence, related primarily to design changes on our 200 Lean disk manufacturing system. Imaging gross margins decreased to 19.8% during the three months ended June 26, 2004 from 21.8% during the three months ended June 28, 2003. The decrease in Imaging margin was due primarily to increased overhead expenditures in 2004.

We expect overall gross margins to decline in the second half of 2004 to a level below our long-term expectations. This is primarily due to higher than expected costs we encountered during the rapid production, installation and startup of the initial production run of 200 Lean systems and due to favorable pricing offered to our first 200 Lean customer

Research and development. Research and development expense consists primarily of prototype materials, salaries and related costs of employees engaged in ongoing research, design and development activities for disk manufacturing equipment, flat panel manufacturing equipment and imaging products. Research and development expense was $3.1 million for each of the three-month periods ended June 26, 2004 and June 28, 2003, representing 17.1% and 67.9%, respectively, of net revenues.

Research and development expenses do not include costs of $1.7 million and $1.4 million, respectively, for the three-month periods ended June 26, 2004 and June 28, 2003 related to Imaging contract research and development. These expenses are included in cost of net revenues.

Selling, general and administrative. Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs and also includes production of customer samples, travel, liability insurance, legal and professional services and bad debt expense. Domestic sales and international sales of disk manufacturing products in Singapore, Malaysia and Taiwan are made by Intevac's direct sales force, whereas other international sales of disk manufacturing products and other products are made by distributors and representatives that provide services such as sales, installation, warranty and customer support. We also have a subsidiary in Singapore to support customers in Southeast Asia.

Selling, general and administrative expense increased to $2.2 million for the three months ended June 26, 2004 from $2.1 million for the three months ended June 28, 2003, representing 12.4% and 46.8%, respectively, of net revenue. The increase was primarily the result of increases in marketing and business development headcount, partially offset by a reduction of surplus facility costs being recorded in selling, general and administrative expense.

Interest expense. Interest expense consists primarily of interest on our convertible notes and amortization of debt issuance costs. We did not incur any interest expense in the three months ended June 26, 2004 and interest expense was $508,000 in the three months ended June 28, 2003. The decrease in interest expense was due to the elimination of our convertible notes outstanding as a result of the automatic conversion of the notes due 2009 in November 2003, and the repayment of the remaining $1.0 million of convertible notes in March 2004.

Interest income and other, net. Interest income and other, net totaled $307,000 and ($148,000) for the three months ended June 26, 2004 and June 28, 2003, respectively. Interest income and other, net in 2004 consisted primarily of interest and dividend income on investments. Interest income and other, net in 2003 consisted primarily of $186,000 of interest and dividend income on investments, offset by the establishment of a $346,000 reserve for the disposition of a fixed asset.

Provision for (benefit from) income taxes. We did not accrue a tax provision for the three-month period ended June 26, 2004 as the profits for this period were offset by net operating loss carry-forwards. We did not accrue a tax benefit for the three-month period ended June 28, 2003 due to the inability to realize additional refunds from loss carry-backs. Our $17.6 million deferred tax asset is fully offset by a $17.6 million valuation allowance, resulting in a net deferred tax asset of zero at June 26, 2004.

Six Months Ended June 26, 2004 and June 28, 2003.

Net revenues. Net revenues increased 48% to $24.5 million for the six months ended June 26, 2004 from $16.6 million for the six months ended June 28, 2003.

Equipment revenues increased to $19.6 million for the six months ended June 26, 2004 from $12.8 million for the six months ended June 28, 2003. The increase in Equipment revenue was the result of the customer acceptance of two 200 Lean systems for revenue, the sale of one MDP-250B system and higher revenue from disk equipment technology upgrades and spare parts in the six months ending June 26, 2004. Imaging revenues increased to $4.9 million for the six months ended June 26, 2004 from $3.8 million for the six months ended June 28, 2003. The increase in Imaging revenues was the result of increased revenues from contract research and development.

International sales decreased by 13% to $10.5 million for the six months ended June 26, 2004 from $12.0 million for the six months ended June 28, 2003. The decrease in international sales was due to 2003 including revenue from the acceptance of flat panel manufacturing systems, which was only partially offset in 2004 by increased shipments of disk equipment systems, technology upgrades and spare parts. International sales constituted 43% of net revenues for the six months ended June 26, 2004 and 72% of net revenues for the six months ended June 28, 2003. International revenues include products shipped to overseas operations of US companies.

Gross margin. Gross margin increased to 30.5% for the six months ended June 26, 2004 from 13.7% for the six months ended June 28, 2003.

Gross margin in Equipment increased to 33.5% for the six-month period ended June 26, 2004 from 11.7% for the six-month period ended June 28, 2003. The increase in Equipment margin was due primarily to the increase in revenue from disk equipment technology upgrades and spare parts and the sale of two 200 Lean systems. Gross margin for the six months ended June 26, 2004 was adversely impacted by costs for scrap and rework and actual and expected obsolescence, related primarily to design changes on our 200 Lean disk manufacturing system. The gross margin in the six months ended June 28, 2003 was depressed due to the majority of revenue being derived from the sale of flat panel systems, which contributed minimal gross margin. Imaging gross margins decreased to 18.2% during the six months ended June 26, 2004 from 20.5% during the six months ended June 28, 2003. The decrease in Imaging margin was due primarily to increased overhead expenditures in 2004.

Research and development. Research and development expense increased 6.9% to $6.1 million for the six months ended June 26, 2004 from $5.7 million for the six months ended June 28, 2003, representing 25.1% and 34.6%, respectively, of net revenue. The increase was due to higher spending for development of disk manufacturing equipment, partially offset by decreases in spending for flat panel manufacturing equipment and imaging products.

Research and development expenses do not include costs of $3.3 million and $2.6 million, respectively, for the six-month periods ended June 26, 2004 and June 28, 2003 related to Imaging contract research and development. These expenses are included in cost of net revenues.

Selling, general and administrative. Selling, general and administrative expense increased 7.9% to $4.4 million for the six months ended June 26, 2004 from $4.1 million for the six months ended June 28, 2003, representing 17.9% and 24.5%, respectively, of net revenue. The increase was primarily the result of increases in marketing and business development headcount, partially offset by a reduction of surplus facility costs being recorded in selling, general and administrative expense.

Interest expense. Interest expense decreased to $12,000 for the six months ended June 26, 2004 from $1.0 million in the six months ended June 28, 2003. The decrease in interest expense was due to the elimination of our convertible notes outstanding as a result of the automatic conversion of our convertible notes due 2009 in November 2003, and the repayment of the remaining $1.0 million of our convertible notes due 2004 in March 2004.

Interest income and other, net. Interest income and other, net totaled $553,000 and ($243,000) for the six months ended June 26, 2004 and June 28, 2003, respectively. Interest income and other, net in 2004 consisted primarily of interest and dividend income on investments and, to a lesser extent, purchase discounts. Interest income and other, net in 2003 consisted primarily of $360,000 of interest and dividend income on investments, offset by the establishment of a $639,000 reserve for the disposition of a fixed asset.

Provision for (benefit from) income taxes. We did not accrue a tax benefit for either of the six-month periods ended June 26, 2004 or June 28, 2003, due to the inability to realize additional refunds from loss carry-backs. The $12,000 credit to income tax expense in 2004 related to a revised estimate of 2003 taxes owed by our Singapore subsidiary.

Liquidity and Capital Resources

Our operating activities used cash of $9.8 million during the six months ended June 26, 2004. The cash used was due primarily to the net loss incurred and increases in inventory and accounts receivable, partially offset by increases in accounts payable and customer advances. The increase in inventories, accounts payable and customer advances all relate to the orders for disk sputtering systems that are expected to be recognized for revenue over the next two quarters. In the six months ended June 28, 2003, our operating activities used cash of $6.7 million due primarily to the net loss incurred and the semi-annual interest payment on our convertible notes.

Our investing activities in the six months ended June 26, 2004 used cash of $29.0 million due primarily to the purchase of investments. Investing activities in the six months ended June 28, 2003 used cash of $1.7 million for the purchase of fixed assets.

Our financing activities provided cash of $41.2 million in the six months ended June 26, 2004 due primarily to a public offering of our common stock and, to a lesser extent, the sale of our common stock through our employee benefit plans. We retired the remaining $1.0 million of our convertible notes during the six months ended June 26, 2004. In the six months ended June 28, 2003, our financing activities provided cash of $0.2 million as the result of the sale of our common stock to our employees through our employee benefit plans.

At June 26, 2004, we had $21.9 million of cash and cash equivalents. We intend to undertake approximately $3 to $4 million in capital expenditures during 2004, and we believe the existing cash and cash equivalent balances will be sufficient to meet our cash requirements for the balance of 2004.

We have incurred operating losses each year since 1998 and cannot predict with certainty if and when we will return to operating profitability on an annual basis. We believe an upturn in demand for the type of disk manufacturing equipment we produce is occurring, and we had orders for ten disk manufacturing systems in our backlog at June 26, 2004, with the revenue from those orders all expected in 2004.

Contractual Obligations

In the normal course of business, we enter into various contractual obligations that will be settled in cash. These obligations consist primarily of operating lease and purchase obligations. The expected future cash flows required to meet these obligations as of June 26, 2004 are shown in the table below. During the six months ending June 26, 2004, we executed an amendment to extend the lease at our Santa Clara facility through March 2012, we entered into a lease for a sensor fabrication facility located in Fremont, California, and we leased a larger facility in Singapore to house our Singapore customer support organization.

	Payments Due by Period				
	Total	<1 Year	1-3 Years	3-5 Years	>5 Years
			(In thousands)		
Operating lease obligations	$18,312	$3,351	$6,515	$3,266	$5,180
Purchase obligations	2,862	2,862	—	—	—
Total	$21,174	$6,213	$6,515	$3,266	$5,180

Certain Factors Which May Affect Future Operating Results

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

Over the last 10 quarters, our revenues per quarter have fluctuated between $18.0 million and $4.6 million. Over the same period our operating income as a percentage of revenues has fluctuated between approximately 3% and (90%) of revenues. We anticipate that our revenues and operating margins will continue to fluctuate. We expect this fluctuation to continue for a variety of reasons, including:

- delays or problems in the introduction and acceptance of our new products, or delivery of existing products;
- changes in the demand, due to seasonality and other factors, for the computer systems, storage subsystems and consumer electronics that contain the thin-film disks that our customers produce using our systems; and
- announcements of new products, services or technological innovations by us or our competitors.

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

The majority of our $46 million backlog is with one customer and is subject to successful installation and achievement of contractual specifications.

Our order backlog was $46 million at June 26, 2004. Orders for nine 200 Lean systems from one customer account for the majority of this backlog. Failure to complete the installation of the 200 Leans and to achieve performance to all contractually committed specifications, could have adverse affects on our business, including delayed customer acceptance and revenue recognition; lowered gross margins due to excess costs such as rework, retrofit and warranty expense; penalties for nonperformance, cancellation of orders or return of products for credit.

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

From the middle of 1998 until mid-2003, there was very little demand for new disk sputtering systems, as thin-film disk manufacturers were burdened with overcapacity and were not investing in new disk sputtering equipment. Recently, however, overcapacity has diminished, and three of our customers have announced plans for major capacity expansions. Customers for our legacy MDP-250B system, who had previously indicated plans to add capacity, have now become more conservative with respect to their capacity expansion plans. Sales of our equipment for capacity expansions are dependent on the capacity expansion plans of our customers and upon whether our customers select our equipment for their capacity expansions. We have no control over our customers' expansion plans, and we cannot assure you that they will select our equipment if they do expand their capacity. Our customers may not implement capacity expansion plans, or we may fail to win orders for equipment for those capacity expansions, which could have a material adverse effect on our business and our operating results. In addition, some manufacturers may choose to purchase used systems from other manufacturers or customers rather than purchasing new systems from us. Furthermore, if hard disk drives were to be replaced by an alternative technology as a primary method of digital storage, demand for our products would decrease.

Sales of our new 200 Lean disk sputtering systems are also dependent on obsolescence and replacement of the installed base of disk sputtering equipment. If technological advancements are developed that extend the useful life of the installed base of systems, then any sales of our 200 Lean will be limited to the capacity expansion needs of our customers, which would have a material adverse effect on our operating results.

We have a recent history of significant losses and may not regain annual profitability. If we do not establish profitable operations in the future, then our share price is likely to decline.

The majority of our revenues and gross profit has historically been derived from sales of disk sputtering equipment. Sales of our disk sputtering equipment were severely depressed from the middle of 1998 until mid-2003. Also, our Imaging business has yet to earn an annual profit. We have experienced an operating loss in each of the last five fiscal years. For fiscal 2003, our operating loss was $10.7 million, and as of December 31, 2003, we had an accumulated deficit of $21.3 million. To regain profitability, we will need to generate and sustain substantially higher revenue while maintaining reasonable cost and expense levels. We cannot assure you that we will regain profitability in the near future, or at all, and if we do regain profitability we cannot assure you that we will be able to sustain profitability on a going-forward basis. If we fail to regain profitability within the time frame expected by securities analysts or investors, then the market price of our common stock will likely decline.

We sell our equipment products to a small number of large customers.

Historically, a significant portion of our revenue in any particular period has been attributable to sales to a limited number of customers. In 2003, three of our customers, in the aggregate, accounted for 75% of our equipment revenues. In addition, our backlog of 200 Lean systems at June 26, 2004 is from a single customer. Orders from a relatively limited number of thin-film disk manufacturers have accounted for, and likely will continue to account for, a substantial portion of our revenues. The loss of, or delays in purchasing by, any one of our large customers would significantly reduce potential future revenues. Furthermore, the concentration of our customer base may lead customers to demand pricing and other terms unfavorable to us.

The majority of our future revenues is dependent on new products. If these new products are not successful, then our results of operations will be adversely affected.

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

We have invested heavily, and continue to invest, in the development of new products. Our 200 Lean disk sputtering system is designed to address the demand for increased areal density in hard disk drives and our customers' concurrent need to produce more complex thin-film disks. Our future revenues depend on the industry recognizing the need for improved recording methodologies and the need for disk sputtering systems that facilitate manufacturing of advanced media with technologies such as perpendicular recording. Our future revenues also depend significantly on the market acceptance of our 200 Lean disk sputtering system, which we have only recently introduced and which competes against a product that has been on the market longer. New products, such as the 200 Lean, will typically bear higher production and warranty costs in comparison to our more established product lines. Additionally, our gross margins on our new products may be lower and more difficult to predict. In particular, the 200 Lean is a complex system that pushes the limits of technology and we have encountered a number of challenges in production, installation and start-up of the first batch of systems. Advanced vacuum manufacturing equipment, such as the 200 Lean, is subject to extensive customer acceptance tests after installation at the customer's factory. These acceptance tests are designed to validate reliable operation to specification in areas such as throughput, vacuum level, robotics, process performance and software features and functionality. These tests are generally more comprehensive for new systems, like the 200 Lean, than for mature systems, such as the MDP-250B, and are designed to highlight any problems typically encountered with early versions of the equipment. Failure to promptly address any of the problems uncovered in these tests could have adverse effects on our business, including rescheduling of backlog, failure to achieve customer acceptance and therefore revenue recognition as anticipated, unanticipated rework and warranty costs, penalties for non-performance, cancellation of orders, or return of products for credit.

Our LIVAR target identification and low light level camera technologies are designed to offer significantly improved capability to military customers. We are also developing commercial products based on the technology we have developed in our Imaging business. None of our imaging products is currently being manufactured in commercial volumes or available for general sale, and we may encounter unforeseen difficulties when we commence general production of these products. Our Imaging business will require substantial further investment in sales and marketing, in product development and in additional production facilities in order to expand our operations. We cannot assure you that we will succeed in these activities or generate significant sales of new products. Failure of any of these products to perform as intended, or failure to penetrate their markets and develop into profitable product lines, would have a material adverse effect on our business.

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

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

The cyclical nature of the capital equipment industry means that in some years we will have unusually high sales of new systems, and that in other years our sales of new systems will be severely depressed. The timing, length and volatility of these cycles are difficult to predict. These changes have affected the timing and amounts of our customers' capital equipment purchases and investments in new technology. For example, sales of systems for thin-film disk production were severely depressed from the middle of 1998 until mid-2003. In addition, our thin-film disk manufacturing customers are generally more sensitive to the cyclical nature of the hard disk drive industry, because many of their customers have internal thin-film disk manufacturing operations and will cut back their purchases of disks from outside suppliers first in an industry downturn. If we fail to anticipate or respond quickly to the industry business cycle, it could have a material adverse effect on our business.

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

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

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

The sales cycle for our equipment systems can be a year or longer, involving individuals from many different areas of our company and numerous product presentations and demonstrations for our prospective customers. Our sales process for these systems also includes the production of samples and customization of products for our prospective customers. Additionally, our Imaging business is subject to long sales cycles as a result of government procurement cycles. As a result, we may not recognize revenue from efforts to sell particular products for extended periods of time, during which we may expend substantial funds and management time and effort with no assurance that a sale will result.

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

In the market for our disk sputtering systems, we have experienced competition from competitors such as Anelva Corporation, a subsidiary of NEC Corporation, Ulvac Technologies, Inc. and Unaxis Holdings, Ltd, each of which has sold substantial numbers of systems worldwide. In the market for our Imaging products, we experience competition from companies such as ITT Industries, Inc. and Northrop Grumman Corporation, the primary U.S. manufacturers of Generation-III night vision devices and their derivative products. Our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do. We cannot assure you that our competitors will not develop enhancements to, or future generations of, competitive products that offer superior price or performance features. Likewise, we cannot assure you that new competitors will not enter our markets and develop such enhanced products. Accordingly, 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 Imaging business depends heavily on government contracts, which are subject to immediate termination and funded in increments. The termination of or failure to fund one or more of these contracts could have a negative impact on our operations.

We sell our products directly to the U.S. government, as well as to prime contractors for various U.S. government programs. Generally, government contracts are subject to oversight audits by government representatives and contain provisions permitting termination, in whole or in part, without prior notice at the government's convenience upon the payment of compensation only for work done and commitments made at the time of termination. We cannot assure you that one or more of the government contracts under which we or our customers operate will not be terminated under these circumstances. Also, we cannot assure you that we or our customers would be able to procure new government contracts to offset the revenues lost as a result of any termination of existing contracts, nor can we assure you that we or our customers will continue to remain in good standing as federal contractors. The loss of one or more government contracts by us or our customers could have a material adverse effect on our operating results.

Furthermore, the funding of multi-year government programs is subject to congressional appropriations, and there is no guarantee that Congress will make further appropriations. The loss of funding for a government program would result in a loss of anticipated future revenues attributable to that program. That could increase our overall costs of doing business and have a material adverse effect on our operating results.

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

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

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

Our stock price is volatile.

The market price and trading volume of our common stock has been subject to significant volatility, and this trend may continue. In particular, our historical trading volume has been low, and the market price of our common stock increased dramatically in late 2003 and early 2004 and has since declined significantly. Over the past 12 months, the closing price of our common stock, as traded on The Nasdaq National Market, has fluctuated from a low of $3.92 to a high of $17.92 per share. The value of our common stock may decline regardless of our operating performance or prospects. Factors affecting our market price include:

- our perceived prospects;
- variations in our operating results and whether we achieve our key business targets;
- sales or purchases of large blocks of our stock;
- changes in, or our failure to meet, our revenue and earnings estimates;
- changes in securities analysts' buy or sell recommendations;
- differences between our reported results and those expected by investors and securities analysts;
- announcements of new contracts, products or technological innovations by us or our competitors;
- market reaction to any acquisitions, joint ventures or strategic investments announced by us or our competitors;
- our high fixed operating expenses, including research and development expenses;
- developments in the financial markets; and
- general economic, political or stock market conditions in the United States and other major regions in which we do business.

Recent events have caused stock prices for many companies, including ours, to fluctuate in ways unrelated or disproportionate to their operating performance. The general economic, political and stock market conditions that may affect the market price of our common stock are beyond our control. The market price of our common stock at any particular time may not remain the market price in the future. In the past, securities class action litigation has been instituted against companies following periods of volatility in the market price of their securities. Any such litigation, if instituted against us, could result in substantial costs and a diversion of management's attention and resources.

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

We are a manufacturing business. Purchased parts constitute the largest component of our product cost. Our ability to manufacture depends on the timely delivery of parts, components, and subassemblies from suppliers. We obtain some of the key components and sub-assemblies used in our products from a single supplier or a limited group of suppliers. If any of our suppliers fail to deliver quality parts on a timely basis, we may experience delays in manufacturing, which could result in delayed product deliveries or increased costs to expedite deliveries or develop alternative suppliers. Development of alternative suppliers could require redesign of our products. Any or all of these factors could have a material adverse effect on our business and operating results.

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

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

- any of our pending or future patent applications will be allowed or that any of the allowed applications will be issued as patents;
- any of our patents will not be invalidated, deemed unenforceable, circumvented or challenged;
- the rights granted under our patents will provide competitive advantages to us;
- any of our pending or future patent applications will issue with claims of the scope that we sought, if at all;

• other parties will not develop similar products, duplicate our products or design around our patents; or

• our patent rights, intellectual property laws or our agreements will adequately protect our intellectual property or competitive position.

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

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

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

Our business is based in Northern California, where operating costs are high and competition for employees is intense.

Our U.S. operations are located in Santa Clara, California, where the cost of doing business is extremely high. Failure to manage these costs well could have a material adverse effect on our operating results. Additionally, our operating results depend, in part, upon our ability to retain and attract qualified management, engineering, marketing, manufacturing, customer support, sales and administrative personnel. The cost of living in Northern California is also extremely high, which increases the cost and difficulty of recruiting new employees. Furthermore, we compete with various similar industries, such as the semiconductor industry, for the same pool of skilled employees. Failure to attract and retain qualified personnel could have a material adverse effect on our business.

Business interruptions, such as earthquakes or other natural or man-made disasters, could disrupt our operations and adversely affect our business.

Our operations are vulnerable to interruption by fire, earthquake, power loss, telecommunications failure, unauthorized intrusion and other catastrophic events beyond our control. Our contingency plans for addressing these kinds of events may not be sufficient to prevent system failures and other interruptions in our operations that have a material adverse effect on our business. Additionally, our suppliers' suffering similar business interruptions could have an adverse effect on our manufacturing ability. If any natural or man-made disasters do occur, our operations could be disrupted for prolonged periods, which could have a material adverse effect on our business.

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

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

We currently quote and sell the majority of our products in U.S. dollars. From time to time, we may enter into foreign currency contracts in an effort to reduce the overall risk of currency fluctuations to our business.

However, there can be no assurance that the offer and sale of products denominated in foreign currencies, and the related foreign currency hedging activities, will not adversely affect our business.

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

We routinely evaluate acquisition candidates and other diversification strategies.

We have completed a number of acquisitions as part of our efforts to expand and diversify our business. For example, our business was initially acquired from Varian Associates in 1991. We acquired our gravity lubrication and rapid thermal processing product lines in two acquisitions. We sold the rapid thermal processing product line in November 2002. We also acquired our RPC electron beam processing business in late 1997, and subsequently closed this business. We intend to continue to evaluate new acquisition candidates, divestiture and diversification strategies. Any acquisition involves numerous risks, including difficulties in the assimilation of the acquired company's employees, operations and products, uncertainties associated with operating in new markets and working with new customers, and the potential loss of the acquired company's key employees. Additionally, unanticipated expenses, difficulties and consequences may be incurred relating to the integration of technologies, research and development, and administrative and other functions. Any future acquisitions may also result in potentially dilutive issuance of equity securities, acquisition- or divestiture-related write-offs or the assumption of debt and contingent liabilities. Any of the above factors could have a material adverse effect on our business.

We use hazardous materials and are subject to risks of non-compliance with environmental and safety regulations.

We are subject to a variety of governmental regulations relating to the use, storage, discharge, handling, emission, generation, manufacture, treatment and disposal of toxic or otherwise hazardous substances, chemicals, materials or waste. If we fail to comply with current or future regulations, such failure could result in suspension of our operations, alteration of our manufacturing process, or substantial civil penalties or criminal fines against us or our officers, directors or employees. Additionally, these regulations could require us to acquire expensive remediation or abatement equipment or to incur substantial expenses to comply with them. Failure to properly manage the use, disposal or storage of, or adequately restrict the release of, hazardous or toxic substances could subject us to significant liabilities.

Our directors, executive officers and affiliates control a significant portion of our outstanding common stock.

Based on the shares outstanding on March 3, 2004, our current directors, executive officers and affiliates, in the aggregate, beneficially owned 26.9% of our outstanding shares of common stock. These shareholders, acting together, are able to exert significant control on matters requiring approval by our shareholders, including the election of directors and approval of significant corporate transactions.

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

Substantially all of our common stock may be sold without restriction in the public markets. Shares held by our directors, executive officers and affiliates are subject to volume and manner of sale restrictions, and as otherwise described in the following sentence. We have an agreement with Foster City LLC and Redemco, LLC, that gives Foster City and Redemco the right to require us to file a registration statement on Form S-3, registering the resale of all shares of our common stock held by Foster City and Redemco. Sales of a substantial number of shares of common stock in the public market or the perception that these sales could occur could materially and adversely affect our stock price and make it more difficult for us to sell equity securities in the future at a time and price we deem appropriate.

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

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

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

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

The table below presents principal amounts and related weighted-average interest rates by year of maturity for our investment portfolio at June 26, 2004.

	2004	2005	2006	2007	2008	Beyond	Total	Fair Value
					(In thousands)			
Cash equivalents								
Variable rate	$19,586	—	—	—	—	—	$19,586	$19,586
Average rate	0.96%	—	—	—	—	—		
Short-term investments								
Variable rate	$10,031	$ 5,601	—	—	—	—	$15,632	$15,632
Average rate	2.52%	3.99%	—	—	—	—		
Long-term investments								
Variable rate	—	$12,187	—	—	—	—	$12,187	$12,187
Average rate	—	3.10%	—	—	—	—		
Total investments								
Variable rate	$29,617	$17,788	—	—	—	—	$47,405	$47,405
Average rate	1.49%	3.38%	—	—	—	—		

Foreign exchange risk. From time to time, we enter into foreign currency forward exchange contracts to economically hedge certain of our anticipated foreign currency transaction, translation and re-measurement exposures. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on our operating results. At June 26, 2004, we had no foreign currency forward exchange contracts.

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

Evaluation of disclosure controls and procedures. An evaluation was carried out under the supervision and with the participation of management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended, the “Exchange Act”)) as of the end of the period covered by this quarterly report. Based on that evaluation, our Chief Executive Officer and our Chief Financial Officer have concluded that our disclosure controls and procedures are effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms.

Changes in internal controls. No change in our internal controls over financial reporting was identified in connection with the evaluation required by Rule 13a-15(d) of the Exchange Act that occurred during our second quarter ended June 26, 2004 that has materially affected, or is reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

From time to time we are involved in litigation incidental to the conduct of our business. We are not party to any lawsuit or proceeding that, in our opinion, is likely to seriously harm our business.

Item 2. *Changes in Securities and Use of Proceeds*

None.

Item 3. *Defaults Upon Senior Securities*

None.

Item 4. *Submission of Matters to a Vote of Security Holders*

Our annual meeting of shareholders was held May 14, 2004. The following actions were taken at this meeting:

	Affirmative Votes	Negative Votes	Votes Withheld	Abstentions and Broker Non-Votes
(a) Election of Directors				
Norman H. Pond	18,909,704	351,257	—	727,532
Kevin Fairbairn	19,041,104	219,857	—	727,532
David S. Dury	18,775,804	485,157	—	727,532
Stanley J. Hill	19,034,504	226,457	—	727,532
David N. Lambeth	18,907,685	353,276	—	727,532
Robert Lemos	18,746,205	514,756	—	727,532
Arthur L. Money	16,184,664	3,076,297	—	727,532
(b) Proposal to approve the 2004 Equity Incentive Plan and reserve 1,200,000 shares for issuance thereunder	12,973,469	2,012,740	—	5,002,284
(c) Ratification of Grant Thornton LLP as independent auditors	18,715,466	541,115	—	731,912

Item 5. *Other Information*

None.

Item 6. *Exhibits and Reports on Form 8-K*

(a) The following exhibits are filed herewith:

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

(b) Reports on Form 8-K:

(1) On April 23, 2004, we filed a report on Form 8-K regarding the issuance of a press release announcing our results for the three months ended March 27, 2004.

(2) On May 18, 2004, we filed a report on Form 8-K regarding a business presentation provided to investors.

(3) On July 13, 2004, we filed a report on Form 8-K regarding the issuance of a press release announcing our results for the three months ended June 26, 2004.

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SIGNATURES

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

INTEVAC, INC.

Date: August 10, 2004

By: /s/ KEVIN FAIRBAIRN

Kevin Fairbairn
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: August 10, 2004

By: /s/ CHARLES B. EDDY III

Charles B. Eddy III
Vice President, Finance and Administration,
Chief Financial Officer, Treasurer and Secretary
(Principal Financial and Accounting Officer)

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EXHIBIT INDEX

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

Exhibit 31.1

I, Kevin Fairbairn certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Intevac, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2004

/s/ KEVIN FAIRBAIRN

Kevin Fairbairn
President, Chief Executive Officer and Director

Exhibit 31.2

I, Charles B. Eddy certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of Intevac, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal controls over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 10, 2004

/s/ CHARLES B. EDDY III

Charles B. Eddy III
Vice President, Finance and Administration,
Chief Financial Officer, Treasurer and Secretary

EXHIBIT 32.1

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER AND CHIEF FINANCIAL OFFICER
PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO**

SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

I, Kevin Fairbairn, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Intevac, Inc. on Form 10-Q for the quarterly period ended June 26, 2004 fully complies with the requirements of Section 13 (a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Intevac, Inc.

By: /s/ KEVIN FAIRBAIRN

Name: Kevin Fairbairn
Title: President, Chief Executive Officer and Director

I, Charles B. Eddy III, certify, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that the Quarterly Report of Intevac, Inc. on Form 10-Q for the quarterly period ended June 26, 2004 fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and that information contained in such Form 10-Q fairly presents in all material respects the financial condition and results of operations of Intevac, Inc.

By: /s/ CHARLES B. EDDY III

Name: Charles B. Eddy III
Title: Vice President, Finance and Administration,
Chief Financial Officer, Treasurer and Secretary

A signed original of this written statement required by Section 906 has been provided to Intevac, Inc. and will be retained by Intevac, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.