

INTEVAC INC

FORM 10-Q (Quarterly Report)

Filed 05/10/99 for the Period Ending 03/27/99

Address	3560 BASSETT STREET SANTA CLARA, CA, 95054
Telephone	4089869888
CIK	0001001902
Symbol	IVAC
SIC Code	3559 - Special Industry Machinery, Not Elsewhere Classified
Industry	Industrial Machinery & Equipment
Sector	Industrials
Fiscal Year	12/31

INTEVAC INC

FORM 10-Q (Quarterly Report)

Filed 5/10/1999 For Period Ending 3/27/1999

Address	356O BASSETT ST SANTA CLARA, California 95054
Telephone	408-986-9888
CIK	0001001902
Industry	Computer Storage Devices
Sector	Technology
Fiscal Year	12/31

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 MARCH 27, 1999

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
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

94-3125814
(IRS EMPLOYER IDENTIFICATION NO.)

3550 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

APPLICABLE ONLY TO CORPORATE ISSUERS:

On March 27, 1999 approximately 11,943,145 shares of the Registrant's Common Stock, no par value, were outstanding.

INTEVAC, INC.

INDEX

NO.		PAGE
---		----
PART I. FINANCIAL INFORMATION		
ITEM 1.	Financial Statements (unaudited)	
	Condensed Consolidated Balance Sheets.....	3
	Condensed Consolidated Statements of Income and Comprehensive Income.....	4
	Condensed Consolidated Statements of Cash Flows.....	5
	Notes to Condensed Consolidated Financial Statements.....	6
ITEM 2.	Management's Discussion and Analysis of Financial Condition and Results of Operations.....	9
ITEM 3.	Quantitative and Qualitative Disclosures About Market Risk.....	17
PART II. OTHER INFORMATION		
ITEM 1.	Legal Proceedings.....	18
ITEM 2.	Changes in Securities.....	18
ITEM 3.	Defaults Upon Senior Securities.....	18
ITEM 4.	Submission of Matters to a Vote of Security-Holders.....	18
ITEM 5.	Other Information.....	18
ITEM 6.	Exhibits and Reports on Form 8-K.....	18
	SIGNATURES.....	19

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

INTEVAC, INC.

**CONDENSED CONSOLIDATED BALANCE SHEETS
(IN THOUSANDS)**

	MARCH 27, 1999	DECEMBER 31, 1998
	-----	-----
	(UNAUDITED)	
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 3,610	\$ 3,991
Short-term investments.....	54,893	56,925
Accounts receivable, net of allowances of \$1,655 and \$1,629 at March 27, 1999 and December 31, 1998, respectively.....	9,799	10,169
Inventories.....	24,505	22,102
Prepaid expenses and other current assets.....	842	658
Deferred tax asset.....	7,008	7,008
	-----	-----
Total current assets.....	100,657	100,853
Property, plant, and equipment, net.....	10,904	13,131
Investment in 601 California Avenue LLC.....	2,431	2,431
Goodwill and other intangibles.....	3,142	3,543
Debt issuance costs.....	1,618	1,700
Deferred tax assets and other assets.....	1,261	1,318
	-----	-----
Total assets.....	\$120,013	\$122,976
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable.....	\$ 2,596	\$ 2,034
Accrued payroll and related liabilities.....	1,765	1,880
Other accrued liabilities.....	6,327	7,535
Customer advances.....	12,044	11,630
	-----	-----
Total current liabilities.....	22,732	23,079
Convertible notes.....	57,500	57,500
Long-term notes payable.....	1,960	1,961
Shareholders' equity:		
Common stock, no par value.....	18,335	17,917
Accumulated other comprehensive income.....	74	122
Retained earnings.....	19,412	22,397
	-----	-----
Total shareholders' equity.....	37,821	40,436
	-----	-----
Total liabilities and shareholders' equity.....	\$120,013	\$122,976
	=====	=====

See accompanying notes.

INTEVAC, INC.

**CONDENSED CONSOLIDATED STATEMENTS OF INCOME
AND COMPREHENSIVE INCOME
(IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)**

(UNAUDITED)

	THREE MONTHS ENDED	
	MARCH 27, 1999	MARCH 28, 1998
Net revenues.....	\$11,749	\$34,235
Cost of net revenues.....	10,762	23,574
	987	10,661
Gross profit.....		
Operating expenses:		
Research and development.....	4,067	3,562
Selling, general and administrative.....	1,899	3,105
Restructuring expense (gain).....	(17)	1,164
	5,949	7,831
Total operating expenses.....		
Operating income (loss).....	(4,962)	2,830
Interest expense.....	(1,015)	(1,016)
Interest income and other, net.....	1,162	771
Income (loss) from continuing operations before income taxes.....	(4,815)	2,585
Provision for (benefit from) income taxes.....	(1,830)	855
	(2,985)	1,730
Income (loss) from continuing operations.....		
Gain from discontinued operations, net of applicable income taxes.....	--	532
Net income (loss).....	\$(2,985)	\$ 2,262
Other comprehensive income:		
Unrealized foreign currency translation adjustment.....	(48)	(10)
	(48)	(10)
Total adjustments.....		
Total comprehensive income.....	\$(3,033)	\$ 2,252
Basic earnings per share:		
Income (loss) from continuing operations.....	\$ (0.25)	\$ 0.14
Net income (loss).....	\$ (0.25)	\$ 0.19
Shares used in per share amounts.....	11,924	12,190
Diluted earnings per share:		
Income (loss) from continuing operations.....	\$ (0.25)	\$ 0.14
Net income (loss).....	\$ (0.25)	\$ 0.18
Shares used in per share amounts.....	11,924	12,511

See accompanying notes.

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

(UNAUDITED)

	THREE MONTHS ENDED	
	MARCH 27, 1999	MARCH 28, 1998
OPERATING ACTIVITIES		
Net income (loss).....	\$(2,985)	\$ 2,262
Adjustments to reconcile net income to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization.....	1,423	1,614
Gain on foreign exchange contracts.....	(641)	--
Gain on sale of discontinued operations.....	--	(794)
Foreign currency (gain) loss.....	5	(12)
Loss on IMAT investment.....	57	37
Restructuring charge -- non-cash portion.....	--	194
Loss on disposal of equipment.....	14	94
Changes in assets and liabilities.....	(331)	(7,685)
Total adjustments.....	527	(6,552)
Net cash and cash equivalents used in operating activities.....	(2,458)	(4,290)
INVESTING ACTIVITIES		
Purchase of investments.....	(968)	(23,037)
Proceeds from sale of investments.....	3,000	7,995
Purchase of leasehold improvements and equipment.....	(373)	(884)
Net cash and cash equivalents provided by (used in) investing activities.....	1,659	(15,926)
FINANCING ACTIVITIES		
Proceeds from issuance of common stock.....	418	551
Repurchase of common stock.....	--	(808)
Net cash and cash equivalents provided by (used in) financing activities.....	418	(257)
Net decrease in cash and cash equivalents.....	(381)	(20,473)
Cash and cash equivalents at beginning of period.....	3,991	24,431
Cash and cash equivalents at end of period.....	\$ 3,610	\$ 3,958
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Cash paid (received) for:		
Interest.....	\$ 1,869	\$ 1,900
Income taxes.....	--	950
Income tax refund.....	(432)	--
Other non-cash changes:		
Inventories transferred to (from) property, plant and equipment.....	\$(1,641)	\$ 1,159

See accompanying notes.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS ACTIVITIES AND BASIS OF PRESENTATION

Intevac, Inc.'s ("Intevac" or the "Company") primary business is the design, manufacture and sale of complex capital equipment that is used to manufacture products such as thin-film disks for computer disk drives and flat panel displays (the "Equipment Business"). The Company also develops highly sensitive electro-optical devices under government sponsored R&D contracts (the "Photonics Business").

The Equipment Business is a leading supplier of sputtering systems used to manufacture thin-film disks for computer hard disk drives. Sputtering is a complex vacuum deposition process used to deposit multiple thin-film layers on a disk. The Equipment Business also realizes revenues from the sales of disk lubrication equipment, contact stop-start ("CSS") test equipment, flat panel display ("FPD") manufacturing equipment and electron beam processing equipment. Spare parts and after-sale service are also sold to purchasers of the Company's equipment, and sales of components are made to other manufacturers of vacuum equipment.

The Photonics Business began in 1995 when the Company's night vision business was sold. The terms of the sale permitted Intevac to utilize the night vision technology for non-competitive products. The majority of Photonics Business revenues are from government sponsored R&D contracts. The Photonics Business has been developing technology that permits highly sensitive detection in the short-wave infrared spectrum in electron sources with very precise characteristics. This development work is aimed at creating new products for both military and industrial applications.

The financial information at March 27, 1999 and for the three-month periods ended March 27, 1999 and March 28, 1998 is unaudited, but includes all adjustments (consisting only of normal recurring accruals) that the Company considers necessary for a fair presentation of the financial information set forth herein, in accordance with generally accepted accounting principles 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 generally accepted accounting principles for annual financial statements. For further information, refer to the Consolidated Financial Statements and footnotes thereto included or incorporated by reference in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.

The preparation of financial statements in conformity with generally accepted accounting principles 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.

The results for the three-month period ended March 27, 1999 are not considered indicative of the results to be expected for any future period or for the entire year.

2. INVENTORIES

The components of inventory consist of the following:

	MARCH 27, 1999	DECEMBER 31, 1998
	-----	-----
	(IN THOUSANDS)	
Raw materials.....	\$ 4,780	\$ 6,907
Work-in-progress.....	14,976	11,653
Finished goods.....	4,749	3,542
	-----	-----
	\$24,505	\$22,102
	=====	=====

A significant portion of the finished goods inventory is represented by completed units at customer sites undergoing installation and acceptance testing.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

3. INCOME TAXES

The effective tax rates used for the three-month periods ending March 27, 1999 and March 28, 1998 were 38% and 33% of pretax income (loss), respectively. These rates are based on the estimated annual tax rate complying with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes".

4. NET INCOME (LOSS) PER SHARE

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

	THREE MONTHS ENDED	
	MARCH 27, 1999	MARCH 28, 1998
	(IN THOUSANDS)	
Numerator:		
Income (loss) from continuing operations.....	\$(2,985)	\$ 1,730
	=====	=====
Net income (loss).....	\$(2,985)	\$ 2,262
	=====	=====
Numerator for basic earnings per share -- income (loss) available to common stockholders.....	(2,985)	2,262
Effect of dilutive securities:		
6 1/2% convertible notes(1).....	--	--
	-----	-----
Numerator for diluted earnings per share -- income (loss) available to common stockholders after assumed conversions.....	\$(2,985)	\$ 2,262
	=====	=====
Denominator:		
Denominator for basic earnings per share -- weighted-average shares.....	11,924	12,190
Effect of dilutive securities:		
Employee stock options(2).....	--	321
6 1/2% convertible notes(1).....	--	--
	-----	-----
Dilutive potential common shares.....	--	321
	-----	-----
Denominator for diluted earnings per share -- adjusted weighted-average shares and assumed conversions.....	11,924	12,511
	=====	=====

(1) Diluted EPS for the three-month periods ended March 27, 1999 and March 28, 1998 excludes "as converted" treatment of the Convertible Notes as their inclusion would be anti-dilutive.

(2) Diluted EPS for the three-month period ended March 27, 1999 excludes the effect of employee stock options as their inclusion would be anti-dilutive.

5. SEGMENT REPORTING

Segment Description

Intevac, Inc. has two reportable segments: equipment and photonics. The Company's equipment business sells complex capital equipment used in the manufacturing of thin-film disks, flat panel displays, shrink-wrap films and for in-line sterilization. The Company's photonics business is developing products utilizing electron sources that permit highly sensitive detection in the short-wave infrared spectrum.

Included in corporate activities are general corporate expenses, elimination of inter-segment revenues, the equity in net loss of equity investee and amortization expenses related to certain intangible assets, less an allocation of corporate expenses to operating units equal to 1% of net revenues.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS -- (CONTINUED)

Business Segment Net Revenues

	THREE MONTHS ENDED	
	MARCH 27, 1999	MARCH 28, 1998
	(IN THOUSANDS)	
Equipment		
Trade.....	\$10,309	\$32,826
Inter-Segment.....	--	13
	-----	-----
	10,309	32,839
Photonics		
Trade.....	1,440	1,409
Corporate Activities.....	--	(13)
	-----	-----
Total.....	\$11,749	\$34,235
	=====	=====

Business Segment Profit & Loss

	THREE MONTHS ENDED	
	MARCH 27, 1999	MARCH 28, 1998
	(IN THOUSANDS)	
Equipment.....	\$(4,267)	\$ 3,104
Photonics.....	(101)	157
Corporate activities.....	(594)	(431)
	-----	-----
Operating income (loss).....	(4,962)	2,830
Interest expense.....	(1,015)	(1,016)
Interest income.....	591	705
Other income and expense, net.....	571	66
	-----	-----
Income (loss) from continuing operations before income taxes.....	\$(4,815)	\$ 2,585
	=====	=====

6. RESTRUCTURING

On March 26 1999, as a result of continued weak demand for its disk equipment, the Company's management implemented a reduction in force of 17 employees out of the Company's staff of contract and regular personnel. The reductions took place at the Company's facilities in Santa Clara, CA. In the first quarter of 1999, the Company incurred a restructuring charge of \$115,000 related to severance costs for the affected employees.

During the first quarter of 1998, the Company's management adopted a plan to reduce expenses. The expense reduction plan included a reduction in force of 90 employees out of the Company's staff of contract and regular personnel. The reductions took place at the Company's facilities in Santa Clara, CA; Los Gatos, CA; Rocklin, CA; and Taiwan. Additionally, the Company relocated its RTP Operation from Rocklin to the Company's Santa Clara headquarters and closed the Rocklin facility. The Company incurred a restructuring charge of \$1,164,000 related to the expense reduction plan. The significant components of this charge include \$290,000 for closure of the Rocklin facility, \$462,000 for the balance of the rent due on the lease for such facility and \$392,000 for employee severance costs.

In the fourth quarter of 1998, \$147,000 of the restructuring reserve was reversed due to lower than expected costs incurred on the closure of the Rocklin facility. During the first quarter of 1999, the Company negotiated an early termination of its lease commitment in Rocklin, CA. This resulted in the Company reversing the remaining \$132,000 of the restructuring reserve established in 1998 for closure of the Rocklin facility.

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. The Company's actual results may differ materially from those discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to, the risk factors set forth elsewhere in this Quarterly Report on Form 10-Q under "Certain Factors Which May Affect Future Operating Results" and in other documents the Company files from time to time with the Securities and Exchange Commission, including the Company's Annual Report on Form 10-K filed in March 1999, Form 10-Q's and Form 8-K's.

RESULTS OF OPERATIONS

Three Months Ended March 27, 1999 and March 28, 1998

Net revenues. Net revenues consist primarily of sales of the Company's disk sputtering systems and related equipment used to manufacture thin-film disks for computer hard disk drives, system components, electron beam processing equipment, flat panel display manufacturing equipment and related equipment and components ("Equipment") and contract research and development related to the development of highly sensitive electro-optical devices under government sponsored R&D contracts ("Photonics"). Net revenues from system sales are recognized upon customer acceptance. Net revenues from sales of related equipment and system components are recognized upon product shipment. Contract research and development revenue is recognized in accordance with contract terms, typically as costs are incurred. Net revenues decreased by 66% to \$11.8 million for the three months ended March 27, 1999 from \$34.2 million for the three months ended March 28, 1998. Net revenues from Equipment sales declined to \$10.3 million for the three months ended March 27, 1999 from \$32.8 million for the three months ended March 28, 1998. The decrease in net revenues from Equipment was due primarily to a decrease in sales of disk manufacturing equipment, and to a lesser extent, a decrease in sales of electron beam processing equipment. Net revenues from Photonics were \$1.4 million in each of the three-month periods ended March 27, 1999 and March 28, 1998. The Company expects that total revenues will continue in the \$10 million to \$15 million range for each of the next two quarters.

International sales decreased by 59% to \$7.5 million for the three months ended March 27, 1999 from \$18.3 million for the three months ended March 28, 1998. The decrease in international sales was primarily due to a decrease in net revenues from disk manufacturing equipment, and to a lesser extent, a decrease in net revenues from electron beam processing equipment. International sales constituted 64% of net revenues for the three months ended March 27, 1999 and 53% of net revenues for the three months ended March 28, 1998.

Backlog. The Company's backlog of orders for its products was \$26.1 million at March 27, 1999 and \$53.6 million at March 28, 1998. The reduction in backlog was primary the result of a lower backlog of orders for Equipment. The Company includes in backlog the value of purchase orders for its products that have scheduled delivery dates.

Gross margin. Cost of net revenues consists primarily of purchased materials, fabrication, assembly, test, installation, warranty costs, scrap and costs attributable to contract research and development. Gross margin was 8.4% for the three months ended March 27, 1999 as compared to 31.1% for the three months ended March 28, 1998. Gross margins declined as the result of underabsorbtion of manufacturing overhead due to low manufacturing volume, establishment of a \$0.4 million cost to market reserve on a used MDP-250B disk sputtering system and establishment of a \$0.4 million cost to market reserve related to higher than expected costs to install and integrate the Company's first production rapid thermal processing system into its customer's production environment. The Company expects that gross margins for the next two quarters will be less than 20% as the result of low manufacturing volume.

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, electron beam processing

equipment and research by the Photonics Division. Company funded research and development expense increased by 14% to \$4.1 million for the three months ended March 27, 1999 from \$3.6 million for the three months ended March 28, 1998, representing 34.6% and 10.4%, respectively, of net revenue. This increase was primarily the result of increased expense for the development of disk manufacturing equipment, which was partially offset by decreased expense for the development of flat panel manufacturing equipment.

Research and development expenses do not include costs of \$1.2 million and \$1.0 million for the three-month periods ended March 27, 1999 and March 28, 1998 related to contract research and development performed by the Company's Photonics business. These expenses are included in cost of goods sold.

Research and development expenses also do not include costs of \$0.1 million in the three months ended March 27, 1999, reimbursed under the terms of a research and development cost sharing agreement with the Company's Japanese flat panel manufacturing equipment development partner. Since 1993 the Company has received \$9.5 million of funds under this cost sharing agreement.

Selling, general and administrative. Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial, travel, management, legal and professional services. Domestic sales are made by the Company's direct sales force, whereas international sales are made by distributors that typically provide sales, installation, warranty and ongoing customer support. The Company also has a subsidiary in Singapore and a branch office in Taiwan to support customers in Southeast Asia. The Company markets its flat panel manufacturing equipment to the Far East through its Japanese joint venture, IMAT. Selling, general and administrative expense decreased by 39% to \$1.9 million for the three months ended March 27, 1999 from \$3.1 million for the three months ended March 28, 1998, representing 16.2% and 9.1%, respectively, of net revenue. The primary reason for the decrease was a lower level of selling, general and administrative expense in the Equipment Business implemented as a result of reduced revenues. The decrease was primarily due to a decline in selling, general and administrative headcount to 45 employees at March 27, 1999 from 91 employees at March 28, 1998 as the result of reductions in force in the Company's staff of contract and regular employees implemented in March and August of 1998 and the reallocation of certain administrative employees to operations.

Restructuring expense (gain). Restructuring expense (gain) was (\$17,000) and \$1.2 million in the three-month periods ended March 27, 1999 and March 28, 1998, respectively. In March 1998, the Company's management adopted a restructuring plan to relocate its Rapid Thermal Processing Operation from Rocklin, California to the Company's Santa Clara, California headquarters and to close the Rocklin facility. The restructuring plan also included an approximate 20% reduction in the worldwide staff of the Company's contract and regular employees. As a result of this plan, the Company expensed approximately \$1.2 million of restructuring expense in the three months ended March 28, 1998. The restructuring expense included approximately \$0.8 million related to closure of the Rocklin facility and approximately \$0.4 million of severance pay for terminated employees. In March 1999 the Company completed a reduction in force of approximately 10% of its worldwide staff and incurred employee severance costs of approximately \$115,000. In March 1999 the Company also negotiated an early termination to its lease commitment in Rocklin which resulted in a \$132,000 reduction to previously expensed closure costs. This \$132,000 credit to restructuring costs was partially offset by the \$115,000 of restructuring costs related to the Company's March 1999 reduction in force.

Interest expense. Interest expense consists primarily of interest on the Company's convertible notes, and to a lesser extent, interest on approximately \$2.0 million of long-term debt related to the purchase of Cathode Technology in 1996. Interest expense was \$1.0 million in each of the three-month periods ended March 27, 1999 and March 28, 1998.

Interest income and other, net. Interest income and other, net consists primarily of interest income on the Company's investments, foreign currency hedging gains and losses, early payment discounts on the purchase of inventories, goods and services and the Company's 49% share of the loss incurred by IMAT. Interest income and other, net increased by 51% to \$1.2 million for the three months ended March 27, 1999 from \$0.8 million for the three months ended March 28, 1998 primarily as the result of \$0.6 million of gains on foreign currency hedging which were partially offset by lower interest income.

Discontinued operations. In the three month period ended March 28, 1998 the Company recorded a gain from discontinued operations of \$0.5 million resulting from the reversal of excess warranty reserves related to the sale of the Company's night vision business in 1995.

Provision for(benefit from) income taxes. The Company's estimated effective tax rate for the three months ended March 27, 1999 was a benefit rate of (38%) compared to a 33% effective tax rate for the three months ended March 28, 1998. The Company's estimated effective tax rates are based on estimated effective tax rates for the respective years. The Company's projected annual effective tax rates for 1999 and 1998 differ from the applicable statutory rates primarily due to benefits from the Company's foreign sales corporation and tax exempt interest income partially offset by nondeductible goodwill amortization.

LIQUIDITY AND CAPITAL RESOURCES

The Company's operating activities used cash of \$2.5 million for the three months ended March 27, 1999. The cash used was due primarily to the net loss incurred by the Company, which was partially offset by depreciation and amortization.

The Company's investing activities provided cash of \$1.7 million for the three months ended March 27, 1999 as a result of the net sale of investments, which was partially offset by the purchase of fixed assets.

The Company's financing activities provided cash of \$0.4 million for the three months ended March 27, 1999 as the result of the sale of the Company's stock to its employees through the Company's employee benefit plans.

YEAR 2000

The Company is preparing for the impact of the arrival of the Year 2000 on its business, as well as on the business of its customers, suppliers and business partners. The "Year 2000 Issue" is a term used to describe the problems created by systems that are unable to accurately interpret dates after December 31, 1999. These problems are derived predominately from the fact that many software programs have historically categorized "years" in a two-digit format. The Year 2000 Issue creates potential risks for the Company, including potential problems in the Company's products as well as in the Information Technology ("IT") and non-IT systems that the Company uses in its business operations. The Company may also be exposed to risks from third parties with which the Company interacts who fail to adequately address their own Year 2000 Issues.

Intevac is in the process of implementing plans to address Year 2000 Issues both within and outside the Company. In addressing the Year 2000 issues and risks, the Company has focused, and will continue to focus, its efforts on the Company's enterprise-wide and departmental operations, products, critical suppliers (including service providers) and key customers. Within Intevac, these efforts are intended to encompass all major categories of computer systems in use by the Company, including those utilized in manufacturing, engineering, sales, finance and human resources. The Company's risk assessment includes understanding the Year 2000 readiness of its critical suppliers. The Company's risk assessment process associated with critical suppliers includes soliciting and analyzing responses to questionnaires, and, where necessary, follow-up with the supplier.

The Company is utilizing a phased approach to identifying and remediating Year 2000 Issues. The first phase, compiling an inventory of all systems that face risks from Year 2000 Issues, was substantially completed by year-end 1998. The evaluation, remediation and validation & implementation phases are expected to be complete by mid-1999 for all areas. The Company is acting to remedy issues as they are revealed, while it simultaneously completes its assessment of Year 2000 risks.

Corrective actions completed to date include the implementation of system upgrades to the Company's materials and financial software, upgrades to file server operating systems and replacement of payroll and human resource software. The Company also issued a Product Information Bulletin to customers outlining the Year 2000 Issues faced by the Company's principal product, the MDP-250 sputtering system, and proposed fixes.

Cost incurred to date in addressing Year 2000 Issues have not been material. Based on assessment and correction projects underway, the Company does not expect the total cost of addressing the Year 2000 Issue to be material. As the Company's risk assessment and correction activities continue, these cost estimates may change. In addition, the Company's total cost estimate does not include potential costs related to any customer or other claims resulting from the Company's failure to adequately correct Year 2000 issues.

Although the Company does not currently expect any significant disruption to its operations or operating results as a result of Year 2000 Issues, the Company is taking all steps it believes are appropriate to identify and resolve any Year 2000 Issues. However, there can be no assurance that the Company will be able to identify, assess and correct Year 2000 Issues in a timely or successful manner. The Company's failure to identify, assess and correct Year 2000 Issues in a timely manner could have a material, adverse effect on the Company's business, financial condition and results of operations.

The Company currently believes that its most reasonably likely worst case Year 2000 scenario would relate to problems with systems of third parties which would create the greatest risks with infrastructure, including water and sewer services, electricity, transportation, telecommunications and critical suppliers of materials and supplies. The Company has not yet prepared a contingency plan for dealing with these potential problems. The Company will be assessing various scenarios and will prepare the necessary contingency plan over the course of 1999.

The foregoing statements regarding the Company's Year 2000 plans and the Company's expectation for resolving these issues and costs associated therewith are forward-looking statements and actual results could vary. The Company's success in addressing Year 2000 Issues could be impacted by the severity of the problems to be resolved within the Company, by Year 2000 Issues affecting its suppliers and service providers and by the costs associated with third party consultants and software necessary to address these issues.

CERTAIN FACTORS WHICH MAY AFFECT FUTURE OPERATING RESULTS

Cyclical Nature of the Disk Drive Industry

The disk drive industry is cyclical and historically has experienced periods of under- and over-supply of product. Periods of oversupply result in significantly reduced demand for thin-film disks and for the capital equipment used to manufacture such disks, including the systems manufactured and marketed by the Company. A number of manufacturers of hard disk drives and a number of their suppliers have been reporting substantial losses. Many of these manufacturers attribute their problems to an excess supply of hard drives, or in the case of component suppliers, an excess supply of components for hard drives (including thin film disks). As a result, during the second half of 1998 the Company experienced significant reductions in quarterly revenues and incurred net losses in the third and fourth quarters of 1998 and the first quarter of 1999. The Company expects to continue to incur net losses through at least the second and third quarters of 1999.

Additionally, the Company has derived a significant proportion of its net revenues from sales of its disk sputtering systems to manufacturers constructing new thin-film disk fabrication facilities. The construction of new thin-film disk fabrication facilities involves extremely large capital expenditures, resulting in few thin-film disk fabrication facilities being constructed worldwide at any particular time. A substantial investment is also required by disk manufacturers to install and integrate additional thin-film disk manufacturing equipment in connection with upgrading or expanding their existing fabrication facilities. These costs are far in excess of the cost of purchasing the Company's system. The magnitude of such capital expenditures has caused certain thin-film disk manufacturers to forego purchasing significant additional thin-film disk manufacturing equipment.

Rapid Technical Change

The Company's ability to remain competitive requires substantial investments in research and development to advance its technologies. The failure to develop, manufacture and market new systems, or to enhance existing systems, would have a material adverse effect on the Company's business, financial condition and results of operations. In the past, the Company has experienced delays from time to time in the

introduction of, and certain technical difficulties with, certain of its systems and enhancements. In addition, the Company's competitors can be expected to continue to develop and introduce new and enhanced products, any of which could cause a decline in market demand for the Company's systems or a reduction in the Company's margins as a result of intensified price competition.

The Company's success in developing and selling equipment depends upon a variety of factors, including accurate prediction of future customer requirements, technology advances, cost of ownership, introduction of new products on schedule, cost-effective manufacturing and product performance in the field. The Company's new product decisions and development commitments must anticipate continuously evolving industry requirements significantly in advance of sales. Any failure to accurately predict customer requirements and to develop new generations of products to meet those requirements would have a sustained material adverse effect on the Company's business, financial condition and results of operations. New product transitions could adversely affect sales of existing systems, and product introductions could contribute to quarterly fluctuations in operating results as orders for new products commence and orders for existing products decline. There can be no assurance that the Company will be successful in selecting, developing, manufacturing and marketing new products or enhancements of existing products.

For example, changes in the manufacturing processes for thin-film disks could have a material adverse effect on the Company's business, financial condition and results of operations. The Company anticipates continued rapid changes in the requirements of the disk drive industry and thin-film disk manufacturing technologies. There can be no assurance that the Company will be able to develop, manufacture and sell systems that respond adequately to such changes. In addition, the computer disk drive industry is subject to constantly evolving technological standards. There can be no assurance that future technological innovations will not reduce demand for thin-film disks. The Company's business, financial condition and results of operations could be materially adversely affected by any trend toward technology that would replace thin-film disks as a storage medium.

Competition

The Company experiences intense competition in the Equipment Business. For example, the Company's disk sputtering business experiences competition worldwide from two principal competitors, Balzers A.G. ("Balzers") and Anelva Corporation ("Anelva"), each of which is a large manufacturer of complex vacuum equipment and thin-film disk manufacturing systems and has sold a substantial number of thin-film disk sputtering machines worldwide. Both Balzers and Anelva have substantially greater financial, technical, marketing, manufacturing and other resources than the Company. There can be no assurance that the Company's competitors will not develop enhancements to, or future generations of, competitive products that will offer superior price or performance features or that new competitors will not enter the Company's markets and develop such enhanced products.

Given the lengthy sales cycle and the significant investment required to integrate equipment into the manufacturing process, the Company believes that once a manufacturer has selected a particular supplier's equipment for a specific application, that manufacturer generally relies upon that supplier's equipment and frequently will continue to purchase any additional equipment for that application from the same supplier. Accordingly, competition for customers in the equipment industry is intense, and suppliers of equipment may offer substantial pricing concessions and incentives to attract new customers or retain existing customers.

International Operations and Foreign Exchange Exposure

Sales and operating activities outside of the United States are subject to certain inherent risks, including fluctuations in the value of the United States 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. The Company earns a significant portion of its revenue from international sales, and these sales have included the installation of the Company's products in European countries and Far Eastern countries such as Japan, Singapore, Malaysia, Korea, Thailand, and Taiwan. All of

the Far Eastern countries with which the Company does business have banking systems and foreign currencies that have experienced serious troubles and therefore subject the Company's customers to substantial business risks. There can be no assurance that any of these factors will not have a material adverse effect on the Company's business, financial condition or results of operations. In particular, although the Company's international sales have historically been denominated in United States dollars, such sales will not all be denominated in dollars in the future, and currency exchange fluctuations in countries where the Company does business could materially adversely affect the Company's business, financial condition and results of operations.

The Company's two principal competitors for disk sputtering equipment are based in foreign countries and have cost structures based on foreign currencies. Accordingly, currency fluctuations could cause the Company's products to be more, or less, competitive than its competitors' products. Currency fluctuations will decrease, or increase, the Company's cost structure relative to those of its competitors, which could impact the Company's gross margins. For example, during 1998 the exchange rate for Japanese Yen fluctuated between approximately 113 Yen/\$ and 147 Yen/\$. The Company generally quotes and sells its products in US dollars. However, for certain Japanese customers, the Company quotes and sells its products in Japanese Yen. The Company, from time to time, enters into foreign currency contracts in an effort to reduce the overall risk of currency fluctuations to the Company's business. However, there can be no assurance that the offer and sale of products in foreign denominated currencies, and the related foreign currency hedging activities will not materially adversely affect the Company's financial condition and results of operations.

Fluctuation in Operating Results

Over the last nine quarters the Company's operating income or (loss) as a percentage of net revenues has fluctuated between approximately (47%) to 16% of net revenues. The Company anticipates that its operating margin will continue to fluctuate. As a result, the Company believes that period-to-period comparisons of its results of operations are not necessarily meaningful and should not be relied upon as indications of future performance.

Diversification and Potential Acquisitions

The Company routinely evaluates acquisition candidates and other diversification strategies. There can be no assurance that the Company's efforts in these areas will be successful. The Company completed one acquisition in 1997 and three acquisitions in 1996. Any future acquisition may result in potentially dilutive issuance of equity securities, the write-off of in-process research and development and the assumption of debt and contingent liabilities, any of which could materially adversely affect the Company's business, financial condition and results of operations. Additionally, as a result of the Company's ongoing repurchase of its stock in the open market, the Company may not be able to use the "pooling of interests" method of accounting in some acquisitions, and the Company may therefore be required to amortize any intangible assets acquired in connection with any acquisition.

Additionally, unanticipated expenses may be incurred relating to the integration of technologies, research and development, and administrative functions. Any acquisition will involve 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.

Manufacturing

The Company's Equipment products have a large number of components and are highly complex systems. The Company's Photonics products are complex devices that require highly sophisticated manufacturing techniques utilizing advanced materials science and vacuum processing. The Company may experience delays and technical and manufacturing difficulties in future introductions or volume production of new systems and devices. In addition, some of the systems built by the Company must be customized to meet individual customer site or operating requirements. The Company has limited manufacturing capacity and may be unable to complete the development or meet the technical specifications of its new systems and

devices or to manufacture and ship these systems and devices in a timely manner. Such an occurrence would materially adversely affect the Company's business, financial condition and results of operations as well as its relationships with customers. In addition, the Company may incur substantial unanticipated costs early in a product's life cycle, such as increased cost of materials due to expediting charges, other purchasing inefficiencies and greater than expected installation and support costs which cannot be passed on to the customer. In certain instances, the Company is dependent upon a sole supplier or a limited number of suppliers, or has qualified only a single or limited number of suppliers, for certain complex components or sub-assemblies utilized in its products. Any of such events could materially adversely affect the Company's business, financial condition and results of operations.

Intellectual Property

There can be no assurance that any of the Company's patent applications will be allowed or that any of the allowed applications will be issued as patents. There can be no assurance that any patent owned by the Company will not be invalidated, deemed unenforceable, circumvented or challenged, that the rights granted thereunder will provide competitive advantages to the Company or that any of the Company's pending or future patent applications will be issued with claims of the scope sought by the Company, if at all. Furthermore, there can be no assurance that others will not develop similar products, duplicate the Company's products or design around the patents owned by the Company. In addition, there can be no assurance that foreign patent rights, intellectual property laws or the Company's agreements will protect the Company's intellectual property rights. Failure to protect the Company's intellectual property rights could have a material adverse effect upon the Company's business, financial condition and results of operations.

There has been substantial litigation in the technology industry regarding intellectual property rights. The Company has from time to time received claims that it is infringing third parties' intellectual property rights. In August 1993, Rockwell International Corporation ("Rockwell") sued the Federal government alleging infringement of certain patent rights with respect to the contracts the Federal government has had with a number of companies, including Intevac. The Federal government has notified Intevac that it may be liable in connection with contracts for certain products in the Company's discontinued night vision business. In January 1999, a settlement was negotiated between the Federal government and Rockwell and approved by the court. Under the settlement, all of Intevac's exposure related to government sales is eliminated. Rockwell has not pursued any claims related to non-governmental sales of the products in question.

In July 1998, CVC Products, Inc. ("CVC") indicated that they believed that the Company was infringing one of their patents relating to sputter source design. Upon investigation, Intevac's patent attorney advised the Company that it was not infringing on CVC's patent. In response to CVC's threats of legal action, Intevac filed a complaint for declaratory judgement of non-infringement and patent invalidity against CVC on December 1, 1998. CVC filed a counterclaim on January 14, 1999. Although the Company believes that it has meritorious defense against the CVC counterclaim, there can be no assurance that the resolution of the claims by CVC will not have a material adverse effect on the Company's business, operating results and financial condition.

There can be no assurance that third parties will not in the future claim infringement by the Company with respect to current or future patents, trademarks, or other proprietary rights relating to the Company's disk sputtering systems, flat panel manufacturing equipment or other products. Any present or future claims, with or without merit, could be time-consuming, result in costly litigation, cause product shipment delays or require the Company to enter into royalty or licensing agreements. Such royalty or licensing agreements, if required, may not be available on terms acceptable to the Company, or at all. Any of the foregoing could have a material adverse effect upon the Company's business, operating results and financial condition.

In addition, the Company believes that one of its competitors may be infringing the Company's patent rights in connection with products currently being offered by this competitor. Although the Company has not undertaken formal legal proceedings, the Company has informed this competitor that the Company believes its patent rights are being infringed and that the Company may undertake litigation to protect its patent rights if necessary. If undertaken, such litigation could be costly, time-consuming and result in legal claims being

made against the Company. This could have a material adverse effect on the Company's business, operating results and financial condition, and, in addition, there could be no assurance that the Company would ultimately prevail in any such litigation.

Retention of Employees

The Company believes that it has good relations with its employees. None of the Company's employees is represented by a labor union, and the Company has never experienced a work stoppage. The Company's operating results will depend in significant part upon its ability to retain and attract qualified management, engineering, marketing, manufacturing, customer support, sales and administrative personnel. Competition in northern California for such personnel is intense and there can be no assurance that the Company will be successful in attracting and retaining such personnel. The failure to attract and retain such personnel could make it difficult to undertake or could significantly delay the Company's research and development efforts and any necessary expansion of its manufacturing capabilities or other activities, which could have a material adverse effect on the Company's business, financial condition and results of operations.

Leverage

In connection with the sale of \$57.5 million of its 6 1/2% Convertible Subordinated Notes Due 2004 in February 1997, the Company incurred a substantial increase in the ratio of long-term debt to total capitalization (shareholders' equity plus long-term debt). The ratio at December 31, 1998 and 1997 was approximately 59.5% and 58.4%, respectively. As a result of this indebtedness, the Company incurred substantial principal and interest obligations. The degree to which the Company is leveraged could have a material adverse effect on the Company's ability to obtain additional financing for working capital, acquisitions or other purposes and could make it more vulnerable to industry downturns and competitive pressures. The Company's ability to meet its debt service obligations will be dependent on the Company's future performance, which will be subject to financial, business and other factors affecting the operations of the Company, many of which are beyond its control.

Possible Volatility of Stock Price

The Company believes that factors such as announcements of developments related to the Company's business, fluctuations in the Company's operating results, failure to meet securities analysts' expectations, general conditions in the disk drive and thin-film media manufacturing industries and the worldwide economy, announcements of technological innovations, new systems or product enhancements by the Company or its competitors, fluctuations in the level of cooperative development funding, acquisitions, changes in governmental regulations, developments in patents or other intellectual property rights and changes in the Company's relationships with customers and suppliers could cause the price of the Company's Common Stock to fluctuate substantially. In addition, in recent years the stock market in general, and the market for small capitalization and high technology stocks in particular, has experienced extreme price fluctuations which have often been unrelated to the operating performance of affected companies. Such fluctuations could adversely affect the market price of the Company's Common Stock.

Concentration of Stock Ownership

Based on the shares outstanding on December 31, 1998, the present directors and their affiliates and executive officers, in the aggregate, own beneficially approximately 56.7% of the Company's outstanding shares of Common Stock. As a result, these shareholders, acting together, are able to effectively control all matters requiring approval by the shareholders of the Company, including the election of a majority of the directors and approval of significant corporate transactions.

Environmental Regulations

The Company is subject to a variety of governmental regulations relating to the use, storage, discharge, handling, emission, generation, manufacture, treatment and disposal of toxic or other hazardous substances,

chemicals, materials or waste. Any failure to comply with current or future regulations could result in substantial civil penalties or criminal fines being imposed on the Company or its officers, directors or employees, suspension of production, alteration of its manufacturing process or cessation of operations. Such regulations could require the Company to acquire expensive remediation or abatement equipment or to incur substantial expenses to comply with environmental regulations. Any failure by the Company to properly manage the use, disposal or storage of, or adequately restrict the release of, hazardous or toxic substances could subject the Company to significant liabilities.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Reference is made to Part III, Item 7, Quantitative and Qualitative Disclosures About Market Risk, in the Registrant's Annual Report on Form 10-K for the year ended December 31, 1998.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

There are no material legal proceedings to which the Company is a party or to which any of its property is subject.

ITEM 2. CHANGES IN SECURITIES

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY-HOLDERS

None.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibits are filed herewith:

EXHIBIT NUMBER -----	DESCRIPTION -----
27.1	Financial Data Schedule

(b) Reports on Form 8-K:

None.

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: May 10, 1999

By: /s/ NORMAN H. POND

*Norman H. Pond
Chairman of the Board, President and
Chief
Executive Officer (Principal
Executive Officer)*

Date: May 10, 1999

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)*

EXHIBIT INDEX

EXHIBIT NUMBER -----	DESCRIPTION -----
27.1	Financial Data Schedule

ARTICLE 5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONDENSED CONSOLIDATED BALANCE SHEET AT MARCH 27, 1999 (UNAUDITED) AND THE CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME (UNAUDITED) FOR THE THREE MONTHS ENDED MARCH 27, 1999, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

MULTIPLIER: 1,000

PERIOD TYPE	3 MOS
FISCAL YEAR END	DEC 31 1999
PERIOD START	JAN 01 1999
PERIOD END	MAR 27 1999
CASH	3,610
SECURITIES	54,893
RECEIVABLES	11,454
ALLOWANCES	1,655
INVENTORY	24,505
CURRENT ASSETS	100,657
PP&E	21,453
DEPRECIATION	10,549
TOTAL ASSETS	120,013
CURRENT LIABILITIES	22,732
BONDS	59,460
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	18,335
OTHER SE	19,486
TOTAL LIABILITY AND EQUITY	120,013
SALES	11,749
TOTAL REVENUES	11,749
CGS	10,762
TOTAL COSTS	10,762
OTHER EXPENSES	5,919
LOSS PROVISION	30
INTEREST EXPENSE	1,015
INCOME PRETAX	(4,815)
INCOME TAX	(1,830)
INCOME CONTINUING	(2,985)
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	(2,985)
EPS PRIMARY	(0.25)
EPS DILUTED	(0.25)

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