INTEVAC INC

FORM 10-Q
(Quarterly Report)

Filed 08/12/97 for the Period Ending 06/28/97

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 8/12/1997 For Period Ending 6/28/1997

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

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q
(MARK ONE)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 28, 1997

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 (I.R.S. 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

FORMER NAME, FORMER ADDRESS AND FORMER FISCAL YEAR, IF CHANGED SINCE LAST REPORT.

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 report(s), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

APPLICABLE ONLY TO ISSUERS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes [ ] No [ ]

APPLICABLE ONLY TO CORPORATE ISSUERS:

On June 28, 1997 approximately 12,533,916 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 28, 1997 (UNAUDITED)	DECEMBER 31, 1996
ASSETS		
Current assets:		
Cash and cash equivalents	$ 456	$ 938
Short-term investments	66,888	--
Accounts receivable, net of allowances of $1,303 and $1,024 at June 28, 1997 and December 31, 1996, respectively	15,394	17,570
Inventories	26,207	25,666
Short-term note receivable, net of allowance of $395 and $1,180 at June 28, 1997 and December 31, 1996, respectively	--	--
Prepaid expenses and other current assets	660	507
Deferred tax asset	4,397	4,397
Total current assets	114,002	49,078
Property, plant, and equipment, net	11,729	9,273
Long-term investments	2,561	--
Investment in 601 California Avenue LLC	2,431	2,431
Goodwill and other intangibles	6,222	7,301
Debt issuance costs	2,184	--
Deferred tax assets and other assets	2	2
Total assets	$ 139,131	$ 68,085
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable	$ --	$ 1,252
Accounts payable	4,078	4,465
Accrued payroll and related liabilities	2,154	1,937
Other accrued liabilities	9,600	4,275
Customer advances	21,701	20,702
Net liabilities of discontinued operations	583	600
Total current liabilities	38,116	33,231
Convertible notes	57,500	--
Long-term notes payable	1,955	730
Deferred tax liability	406	388
Shareholders' equity:		
Common stock, no par value	17,172	16,747
Retained earnings	23,982	16,989
Total shareholders' equity	41,154	33,736
Total liabilities and shareholders' equity	$ 139,131	$ 68,085

See accompanying notes.

INTEVAC, INC.

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

(UNAUDITED)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 28, 1997	JUNE 29, 1996	JUNE 28, 1997	JUNE 29, 1996
Net revenues	$ 33,763	$ 20,235	$ 64,904	$ 35,361
Cost of net revenues	23,622	12,228	44,619	21,431
Gross profit	10,141	8,007	20,285	13,930
Operating expenses:				
Research and development	1,902	2,006	4,462	3,385
Selling, general and administrative	2,821	1,958	5,421	3,845
Acquired in-process research and development	--	5,835	--	5,835
Total operating expenses	4,723	9,799	9,883	13,065
Operating income (loss)	5,418	(1,792)	10,402	865
Interest expense	(1,048)	(29)	(1,448)	(55)
Interest income and other, net	1,218	222	1,973	509
Income (loss) from continuing operations before income taxes	5,588	(1,599)	10,927	1,319
Provision for income taxes	2,011	1,626	3,934	2,647
Net income (loss)	$ 3,577	$ (3,225)	$ 6,993	$ (1,328)
Primary earnings per share	$ 0.27	$ (0.26)	$ 0.53	$ (0.11)
Shares used in per share amounts	13,074	12,256	13,094	12,252
Fully diluted earnings per share	$ 0.26	$ (0.26)	$ 0.52	$ (0.11)
Shares used in per share amounts	15,862	12,256	14,995	12,252

See accompanying notes.

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(IN THOUSANDS)

(UNAUDITED)

	SIX MONTHS ENDED	
	JUNE 28, 1997	JUNE 29, 1996
OPERATING ACTIVITIES		
Net income (loss)	$ 6,993	$ (1,328)
Adjustments to reconcile net income (loss) to net cash and cash equivalents provided by operating activities:		
Depreciation and amortization	2,337	953
Acquired in-process research and development	--	5,835
Gain on sale of Chorus Investment	(785)	--
Loss on disposal of equipment	21	--
Changes in assets and liabilities	7,637	(4,433)
Total adjustments	9,210	2,355
Net cash and cash equivalents provided by operating activities	16,203	1,027
INVESTING ACTIVITIES		
Purchase of investments	(82,570)	(2,571)
Proceeds from sale of investments	13,557	1,571
Proceeds from sale of Chorus Investment	785	--
Investment in Cathode Technology Corporation	--	(1,074)
Investment in San Jose Technology Corporation	--	(2,270)
Investment in Lotus Technologies, Inc	--	(8,135)
Investment in IMAT	(436)	--
Purchase of leasehold improvements and equipment	(3,626)	(2,297)
Net cash and cash equivalents used in investing activities	(72,290)	(14,776)
FINANCING ACTIVITIES		
Net borrowings under line of credit agreement	(2)	--
Notes payable repayments	(25)	--
Proceeds from issuance of common stock	425	23
Proceeds from convertible bond offering	55,207	--
Net cash and cash equivalents provided by financing activities	55,605	23
Net decrease in cash and cash equivalents	(482)	(13,726)
Cash and cash equivalents at beginning of period	938	20,422
Cash and cash equivalents at end of period	$ 456	$ 6,696
SUPPLEMENTAL SCHEDULE OF CASH FLOW INFORMATION		
Cash paid (received) for:		
Interest	$ 53	$ --
Income taxes	3,750	3,095
Income tax refund	--	(250)
Other non-cash changes:		
Investment in Cathode Technology Corporation through assumption of notes payable	$ --	$ 1,980

See accompanying notes.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. BUSINESS ACTIVITIES AND BASIS OF PRESENTATION

Intevac, Inc. ("Intevac" or the "Company") is a leading supplier of static sputtering systems and related manufacturing equipment 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 Company's primary objective is to be the industry leader in supplying disk sputtering equipment by providing disk sputtering systems which have both the highest overall performance and the lowest cost of ownership in the industry. The Company's principal product, the MDP-250B, which is the fourth generation of the Company's Magnetic Disk Processing ("MDP") system, enables disk manufacturers to achieve high coercivities, high signal-to-noise ratios, minimal disk defects, durability and uniformity, all of which are necessary in the production of high performance, high capacity disks. The Company sells its static sputtering systems and related manufacturing equipment to both captive and merchant thin-film disk manufacturers. The Company sells and markets its products directly in the United States, and through exclusive distributors in Japan and Korea. The Company has established a subsidiary in Singapore and a branch office in Taiwan to support its customers in Southeast Asia.

The Company also realizes revenues from the sales of system components and from contract research and development activities. Intevac's system component business consists primarily of sales of spare parts and after-sale service to purchasers of the Company's disk sputtering systems, as well as sales of components to other manufacturers of vacuum equipment. Contract research and development revenues have been primarily derived from contracts with the Defense Advanced Research Projects Agency ("DARPA") for development projects for the flat panel display ("FPD") industry.

The financial information at June 28, 1997 and for the three- and six-month periods ended June 28, 1997 and June 29, 1996 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, they do 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, 1996.

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- and six-month periods ended June 28, 1997 are not considered indicative of the results to be expected for any future period or for the entire year.

2. INVESTMENTS

The Company invests its excess cash in high-quality debt instruments. Management determines the appropriate classification of debt securities at the time of purchase and reevaluates such designation as of each balance sheet date. At June 28, 1997 all of the Company's marketable investments were designated as available-for-sale under Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities." Securities classified as available-for-sale are reported at fair market value with the related unrealized gains and losses included in retained earnings. Realized gains and losses and declines in value judged to be other-than-temporary on available-for-sale securities are included in other income and expenses. The cost of securities sold is based on the specific identification method. Interest and dividends on the investments are included in interest income.

The following is a summary of the Company's available-for-sale securities:

	JUNE 28, 1997
	(IN THOUSANDS)
Tax-exempt municipal bonds	$ 69,013
Amounts included in short-term investments	$ 66,888
Amounts included in long-term investments	2,125
	$ 69,013

At June 28, 1997, the carrying amount of securities approximated the fair value (quoted market price), and the amount of unrealized gain or loss was not significant. Gross realized gains and losses for the first half of 1997 were not significant. The long-term investments are due within one year to fourteen months.

3. INVENTORIES

The components of inventory consist of the following:

	JUNE 28, 1997	DECEMBER 31, 1996
	(IN THOUSANDS)	
Raw materials	$ 7,905	$ 6,953
Work-in-progress	16,601	11,728
Finished goods	1,701	6,985
	$ 26,207	$ 25,666

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

4. CONVERTIBLE NOTES

During the first quarter of 1997, the Company completed an offering of $57.5 million of its 6 1/2% Convertible Subordinated Notes, which mature on March 1, 2004. The notes are convertible into shares of the Company's common stock at $20.625 per share. Expenses associated with the offering of approximately $2.3 million are deferred. Such expenses are being amortized to interest expense over the term of the note.

5. INCOME TAXES

The effective tax rate used for the six-month periods ending June 28, 1997 and June 29, 1996 were 36% and 37% (after excluding the $5.8 million of non-tax deductible acquisition related in-process research and development expense) of pretax income, respectively. This rate is based on the estimated annual tax rate complying with Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes."

6. NET INCOME PER SHARE

Net income per share is computed using the weighted average number of shares of common stock and common equivalent shares, when dilutive, from convertible notes (using the as-if-converted method) and from stock options (using the treasury stock method). During the first quarter of 1997, the Company issued subordinated convertible notes. These securities are included in fully diluted earnings per share computations for the period outstanding under the "if converted" method.

In February 1997, the Financial Accounting Standards Board issued Statement No. 128, "Earnings per Share" ("SFAS 128"), which is required to be adopted on December 31, 1997. At that time, the Company will be required to change the method currently used to compute earnings per share and to restate all prior periods. Under the new requirements for calculating basic earnings per share, the dilutive effect of stock options will be excluded. The impact is expected to result in basic earnings per share as follows:

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 28, 1997	JUNE 29, 1996	JUNE 28, 1997	JUNE 29, 1996
Basic earnings per share	$ 0.29	$(0.26)	$ 0.56	$(0.11)

The impact of SFAS 128 on the calculation of fully diluted earnings per share for these periods is not expected to be material.

7. RESEARCH AND DEVELOPMENT COST SHARING AGREEMENT

The Company entered into an agreement with a Japanese company to perform best efforts joint research and development work. The nature of the project is to develop a glass coating machine to be used in the production of flat panel displays. The Company was funded for one-half of the actual costs of the project up to a ceiling of $5,450,000. During the second quarter of 1997 the Company amended this agreement with its Japanese development partner to provide further funding of the joint research and development work. During the second quarter of 1997 the Company received an additional $1,000,000 advance under the amended agreement, bringing the total advances received under the contract to $6,450,000. Offsets against research and development expense of $1,000,000 were recognized under the amended agreement during the second quarter of 1997. The Company does not expect to recognize significant additional credits against research and development expense under the amended agreement until 1998.

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. 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 February 1997, Form 10-Q's and Form 8-K's.

OVERVIEW

Intevac is a leading supplier of static sputtering systems and related manufacturing equipment 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 Company has three primary sources of net revenues: sales of disk sputtering systems and related disk manufacturing equipment; sales of system components; and contract research and development activities. Disk sputtering systems and related disk manufacturing equipment generally represent the majority of the Company's revenue and are sold to vertically integrated disk drive manufacturers and to original equipment manufacturers that sell disk media to disk drive manufacturers. Intevac's system component business consists primarily of sales of spare parts and aftersale service to purchasers of the Company's disk sputtering systems, as well as sales of components to other manufacturers of vacuum equipment. Contract research and development revenues have been primarily derived from contracts with DARPA for development projects for the FPD industry. During the first quarter of 1997 the Company received its first order for the design and delivery of a scaled up version of its D-STAR FPD sputtering machine. To date, revenue from the sale of FPD sputtering equipment has not been material.

In the first quarter of 1996, the Company acquired Cathode Technology Corporation ("CTC"), a designer and manufacturer of magnetron sputter sources for use in the Company's disk sputtering systems. In the second quarter of 1996, the Company acquired San Jose Technology Corp. ("SJT") and Lotus Technologies, Inc. ("Lotus"). SJT is a manufacturer of systems used to lubricate thin film disks. Lotus is a manufacturer of contact stop/start test equipment for disk drives and drive components.

In the first quarter of 1997, the Company completed the sale of $57.5 million of its 6 1/2% Convertible Subordinated Notes Due 2004 (the "Convertible Notes").

The Company's backlog was $77.9 million and $68.2 million at June 28, 1997 and June 29, 1996, respectively. The Company includes in backlog the value of purchase orders for its products with scheduled delivery dates. Delivery dates may be rescheduled from time to time.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 28, 1997 AND JUNE 29, 1996

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, and to a lesser extent, system components and contract research and development. Net revenues from the sales of systems are recognized upon customer acceptance. System component sales are recognized upon product shipment, and contract research and development is recognized in accordance with contract terms, typically as costs are incurred. Net revenues increased by 67% to $33.8 million for the three months ended June 28, 1997 from $20.2 million for the three months ended June 29, 1996. The increase in net revenues was primarily due to an increase in the sales of disk sputtering systems. To a lesser extent, revenues increased as a result of increased contract research and development and higher sales of new products acquired in the acquisitions of SJT and Lotus. Based upon the scheduled shipment dates of the current backlog of orders, the Company expects that its net revenues for the three months ending September 27, 1997 will decline substantially from net revenues for the three months ended June 28, 1997.

International sales increased by 136% to $16.5 million for the three months ended June 28, 1997 from $7.0 million for the three months ended June 29, 1996. The increase in revenues from international sales was primarily due to an increase in the sales of disk sputtering systems. International sales constituted 49% of net revenues for the three months ended June 28, 1997 and 35% of net revenues for the three months ended June 29, 1996.

Gross margin. Cost of net revenues consists primarily of purchased materials, fabrication, assembly, test, installation, international distributor costs, warranty costs and, to a lesser extent, costs attributable to contract research and development. Gross margin as a percentage of net revenues was 30.0% for the three months ended June 28, 1997 as compared to 39.6% for the three months ended June 29, 1996. The reduction in gross margins was primarily due to reduced margins on disk sputtering systems for which product costs increased more than the Company's ability to increase prices. To a lesser extent, margins decreased as the result of lower margin contract research and development activities representing a larger percentage of total revenue for the three months ended June 28, 1997. The Company believes that gross margins will continue to decline during the three months ending September 27, 1997 as the result of decreased sales and 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 sputtering equipment, flat panel manufacturing equipment, and research by the Company's Advanced Technology Division. Research and development expense declined to $1.9 million for the three months ended June 28, 1997 from $2.0 million for the three months ended June 29, 1996, representing 5.6% and 9.9%, respectively, of net revenues. The decrease was primarily the result of increased development expense in disk manufacturing products and flat panel display manufacturing products which were more than offset by cost sharing from the Company's D-STAR development partner and research and development expense transferred to cost of sales under a DARPA development contract. The Company does not expect significant additional credits to research and development expense under either of these programs during 1997.

Research and development expenses do not include costs of $1.0 million and $0.4 million in the three months ended June 28, 1997 and June 29, 1996, respectively, reimbursed to the Company under the terms of a research and development cost sharing agreement with the Company's Japanese D-STAR development partner, nor do they include costs of $1.0 million in the three months ended June 28, 1997 reimbursed to the Company under a DARPA development contract funding development of the D-STAR and delivery of a beta-site unit. In addition, research and development expenses do not include other expenditures in connection with contract research and development activities as these are charged to cost of sales.

Selling, general and administrative. Selling, general and administrative expense consists primarily of selling, marketing, financial, travel, management, legal and professional services costs. 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. Selling, general and administrative expense increased by 44% to $2.8 million for the three months ended June 28, 1997 from $2.0 million for the three months ended June 29, 1996 representing 8.4% and 9.7%, respectively, of net revenues. The increase in selling, general and administrative expense was primarily the result of increased expense associated with the marketing and support of disk sputtering systems, and to a lesser extent, increased costs of marketing and support of the Company's contact stop-start systems and disk lubrication systems. Administrative headcount grew to 87 employees at June 28, 1997 from 69 employees at June 29, 1996.

Acquired in-process research and development. The Company recognized a $5.8 million charge to earnings for the three months ended June 29, 1996 as the result of a write-off of acquired in-process research and development related to the acquisitions of SJT and Lotus. No similar charge was incurred during the second quarter of 1997.

Interest expense. Interest expense consists primarily of interest on the Company's 6 1/2% Convertible Notes issued in the first quarter of 1997.

Interest and other income, net. Interest and other income consists primarily of interest income on the Company's investments, income related to the sale of the Company's 20% interest in the capital stock of Chorus, and early payment discounts on the purchase of inventories, goods and services. Interest and other income, net increased to $1.2 million for the three months ended June 28, 1997 from $0.2 million for the three months ended June 29, 1996 as the result of an increase in interest income and in income related to the sale of the Company's 20% interest in the capital stock of Chorus.

Provision for income taxes. Income tax expense as a percentage of pretax income for the three months ended June 28, 1997 and June 29, 1996, was 36% and 38% (after excluding the $5.8 million of non-tax deductible acquisition related inprocess research and development expense), respectively. The Company's tax rate for these periods differs from the applicable statutory rates primarily due to tax exempt interest income and state income taxes.

SIX MONTHS ENDED JUNE 28, 1997 AND JUNE 29, 1996

Net revenues. Net revenues increased by 84% to $64.9 million for the six months ended June 28, 1997 from $35.4 million the six months ended June 29, 1996. The increase in net revenues was primarily due to an increase in the sales of disk sputtering systems. To a lesser extent, revenues increased as a result of new products acquired in the acquisitions of SJT and Lotus and increased contract research and development. Based upon its current backlog of orders and the scheduled shipment dates, the Company expects that net revenues during the six months ended December 31, 1997 will approximate the net revenues experienced during the six months ended June 28, 1997.

International sales increased by 126% to $31.2 million for the six months ended June 28, 1997 from $13.8 million for the six months ended June 29, 1996. The increase in revenues from international sales was primarily due to an increase in the sales of disk sputtering systems. International sales constituted 48% of net revenues for the six months ended June 28, 1997 and 39% of net revenues for the six months ended June 29, 1996.

Gross margin. Gross margin was 31.3% for the six months ended June 28, 1997 as compared to 39.4% for the six months ended June 29, 1996. The reduction in gross margins was primarily due to reduced margins on disk sputtering systems for which product costs increased more than the Company's ability to increase prices. To a lesser extent, margins decreased as the result of lower margin contract research and development activities representing a larger percentage of total revenue for the six months ended June 28, 1997. The Company believes that gross margins experienced during the six months ended June 28, 1997 are indicative of margins anticipated for the six month period ending December 31, 1997.

Research and development. Research and development expense increased to $4.5 million for the six months ended June 28, 1997 from $3.4 million for the six months ended June 29, 1996, representing 6.9% and 9.6%, respectively, of net revenues. The increase was primarily the result of increased development expense in disk manufacturing products and flat panel display manufacturing products which were partially offset by cost sharing from the Company's D-STAR development partner and by research and development expense transferred to cost of sales under a DARPA development contract.

Research and development expenses do not include costs of $1.0 million and $0.8 million in the six months ended June 28, 1997 and June 29, 1996, respectively, reimbursed to the Company under the terms of a research and development cost sharing agreement with the Company's Japanese D-STAR development partner, nor do they include costs of $1.5 million in the six months ended June 28, 1997 reimbursed to the Company under a DARPA development contract funding development of the D-STAR and delivery of a beta-site unit. In addition, research and development expenses do not include other expenditures in connection with contract research and development activities as these are charged to cost of sales.

Selling, General and Administrative. Selling, general and administrative expense increased by 41% to $5.4 million for the six months ended June 28, 1997 from $3.8 million for the six months ended June 29, 1996 representing 8.4% and 10.9%, respectively, of net revenues. The increase in selling, general and administrative expense was primarily the result of increased expense associated with the marketing and support of disk sputtering systems, and to a lesser extent, increased costs of marketing and support of the Company's contact stop-start systems and disk lubrication systems.

Acquired in-process research and development. The Company recognized a charge for acquired in-process research and development of $5.8 million for the six months ended June 29, 1996, as a result of the acquisitions of SJT and Lotus. No similar charge was incurred during the six months ended June 28, 1997.

Interest expense. Interest expense consists primarily of interest on the Company's 6 1/2% Convertible Notes issued in the first quarter of 1997.

Interest and other income, net. Interest and other income consists primarily of interest income on the Company's investments, income related to the sale of the Company's 20% interest in the capital stock of Chorus, and early payment discounts on the purchase of inventories, goods and services. Interest and other income, net increased to $2.0 million for the six months ended June 28, 1997 from $0.5 million for the six months ended June 29, 1996 as the result of increased income related to the sale of the Company's 20% interest in the capital stock of Chorus and increased interest income.

Provision for income taxes. Income tax expense as a percentage of pretax income for the six months ended June 28, 1997 and June 29, 1996 was 36% and 37% (after excluding the $5.8 million of non-tax deductible acquisition related in-process research and development expense), respectively. The Company's tax rate for these periods differs from the applicable statutory rates primarily due to tax exempt interest income and state income taxes.

LIQUIDITY AND CAPITAL RESOURCES

The Company's operating activities provided cash of $16.2 million for the six months ended June 28, 1997. The cash provided was due primarily to net income, increased accrued expenses, decreased accounts receivable, depreciation and amortization which was partially offset by an increase in inventory and a decrease in accounts payable.

The Company's investing activities used cash of $72.3 million for the six months ended June 28, 1997 due primarily to the net purchase of investments, and to a lesser extent, the purchase of capital equipment and leasehold improvements.

The Company's financing activities provided cash of $55.6 million for the six months ended June 28, 1997, primarily due to the sale by the Company of its Convertible Notes.

In July 1997, the Company announced a common stock repurchase plan. The repurchased shares will be used to meet the Company's current and near-term stock requirements for its employee stock issuance plans.

CERTAIN FACTORS WHICH MAY AFFECT FUTURE OPERATING RESULTS

Fluctuations of Results of Operations

The Company's operating results have historically been subject to significant quarterly and annual fluctuations. The Company derives most of its net revenues from the sale of a relatively small number of sputtering systems. The number of systems accepted by customers in any particular quarter has varied from zero to eleven and, as a result, the Company's net revenues and operating results for a particular period could be materially adversely affected if an anticipated order for even one system is not received in time to permit shipment and customer acceptance during that accounting period. The Company's backlog at the beginning of a quarter may not include all system orders needed to achieve the Company's revenue objectives for that quarter. The scheduled shipment dates of the Company's backlog as of June 28, 1997 indicate that the Company will likely recognize a substantial decline in revenue during the third quarter of 1997 from the level experienced during the first two quarters of 1997.

In addition, orders in backlog are subject to cancellation, and although in some cases the Company requires a deposit on orders for its systems, such deposits may not be sufficient to cover the expenses incurred by the Company for the manufacture of the canceled systems or fixed operating expenses associated with such systems to the date of cancellation. From time to time, in order to meet anticipated customer demand, the Company has manufactured disk sputtering systems in advance of the receipt of orders for such systems. The Company expects to continue this practice in the future. In the event that anticipated orders are not received as expected, the Company could be materially adversely affected by higher inventory levels and increased exposure to surplus and obsolete inventory write-offs. Orders may be subject to cancellation, delay, deferral or rescheduling by a customer. From the date the Company receives an order, it often takes more than six months before the net revenues from such order are recognized and even longer before final payment is received. The relatively long manufacturing cycles of many of the Company's products have caused and could cause shipments of such products to be delayed from one quarter to the next, which could materially adversely affect the Company's business, financial condition and results of operations for a particular quarter. Announcements by the Company or its competitors of new products and technologies could cause customers to defer purchases of the Company's existing systems, which would have a material adverse effect on the Company's business, financial condition and results of operations.

Installing and integrating new sputtering systems into the thin-film disk manufacturing process requires a substantial investment by a customer. Therefore, customers often require a significant number of product presentations and demonstrations, as well as substantial interaction with the Company's senior management, before making a purchasing decision. Accordingly, the Company's systems typically have a lengthy sales cycle during which the Company may expend substantial funds and management time and effort with no assurance that a sale will result. Furthermore, the Company's expense levels are based, in part, on its expectations as to future net revenues. If revenue levels are below expectations, operating results are likely to be adversely affected. Net income, if any, may be disproportionately affected by a reduction in net revenues because a proportionately smaller amount of the Company's expenses varies with its net revenues. The impact of these and other factors on the Company's revenues and operating results in any future period cannot be forecasted with certainty. Due to all of the foregoing factors, the Company expects its quarterly operating results to fluctuate significantly and may in certain quarters be below the expectations of securities analysts and investors. In such event it is likely the price of the Company's Common Stock would be materially adversely affected.

The Company believes that its operating results will continue to fluctuate on a quarterly and annual basis due to a variety of factors. These factors include the cyclicality of the thin-film disk manufacturing and disk drive industries, patterns of capital spending by customers, the timing of significant orders, order cancellations and shipment reschedulings, market acceptance of the Company's products, unanticipated delays in design, engineering or production or in customer acceptance of product shipments, changes in pricing by the Company or its competitors, the timing of product announcements or introductions by the Company or its competitors, discounts offered by the Company to sell demonstration units, the mix of systems sold, the relative proportions of sputtering systems, system components and subassemblies, and contract research and development net revenues, the availability and cost of components and subassemblies, changes in product development costs, expenses associated with acquisitions and exchange rate fluctuations. Over the last ten quarters the Company's gross margin and operating income (loss) as a percentage of net revenues has fluctuated from approximately 30% to 40% of net revenues and (9)% to 21% of net revenues, respectively. The Company anticipates that its gross and operating margins 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.

Cyclicality of the Media Industry

The Company's business depends upon capital expenditures by manufacturers of thin-film disks, including manufacturers that are opening new fabrication facilities, expanding or upgrading existing facilities or replacing obsolete equipment, which in turn depend upon the current and anticipated market demand for hard disk drives. The disk drive industry is cyclical and historically has experienced periods of oversupply. Within the past year, many media manufacturers have increased capacity. In addition, Hyundai has announced plans to commence media manufacturing. This industry-wide increase in capacity may lead to a period of oversupply of thin-film disks, resulting in significantly reduced demand for thin-film disk production and for the capital equipment used in such production, including the systems manufactured and marketed by the Company. In recent years, particularly in very recent periods, the disk drive industry has experienced significant growth, which, in turn, has caused significant growth in the capital equipment industry supplying manufacturers of thin-film disks. There can be no assurance that such growth will continue. The Company anticipates that a significant portion of new orders will depend upon demand from thin-film disk manufacturers building or expanding fabrication facilities, and there can be no assurance that such demand will exist. The Company's business, financial condition and results of operations could be materially adversely affected by downturns or slowdowns in the disk drive market.

Sales of the Company's systems depend, in significant part, upon the decision of a prospective customer to replace obsolete equipment or to increase manufacturing capacity by upgrading or expanding existing manufacturing facilities or constructing new manufacturing facilities, all of which typically involve a significant capital commitment. In addition, the cyclicality of the disk drive industry, among other factors, may cause prospective customers to postpone decisions regarding major capital expenditures, including purchases of the Company's systems. In the event customers delay the purchase of the Company's systems, the Company's business, financial condition and results of operations could be materially adversely affected.

Intense Competition

The Company experiences intense competition worldwide from three principal competitors, Ulvac Japan, Ltd. ("Ulvac"), Balzars A.G. ("Balzars") 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. Each of Ulvac, Balzars and Anelva is a manufacturer of in-line and static sputtering systems, and each has substantially greater financial, technical, marketing, manufacturing and other resources than the Company. The Company also experiences competition from other manufacturers of in-line sputtering systems used in thin-film disk fabrication facilities as well as the manufacturers of thin-film disks that have developed the capability to manufacture their own sputtering systems. 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. Furthermore, the failure of manufacturers of thin-film disks currently using in-line machines and manufacturers using internally developed sputtering systems to switch to static sputtering systems in the future could adversely affect the Company's ability to increase its sputtering system market share.

In addition, the Company's three principal competitors are based in foreign countries and have cost structures and system prices based on foreign currencies. Accordingly, currency fluctuations could cause the Company's dollar-priced products to be less competitive than its competitors' products priced in other currencies. Currency fluctuations could also increase the Company's cost structure relative to those of its competitors, which could make it more difficult for the Company to maintain its competitiveness.

Given the lengthy sales cycle and the significant investment required to integrate a disk sputtering system into the manufacturing process, the Company believes that once a thin-film disk manufacturer has selected a particular supplier's disk sputtering equipment, the manufacturer generally relies upon that equipment for the specific production line application and frequently will continue to purchase its other disk sputtering equipment from the same supplier. The Company expects to experience difficulty in selling to a particular customer for a significant period of time if that customer selects a competitor's disk sputtering equipment. Accordingly, competition for customers in the disk sputtering equipment industry is particularly intense, and suppliers of disk sputtering equipment may offer pricing concessions and incentives to attract customers, which could adversely affect the Company's business, financial condition, gross margins and results of operations. Because of these competitive factors, there can be no assurance that the Company will be able to compete successfully in the future.

Customer Concentration

Historically, a significant portion of the Company's revenues in any particular period have been attributable to sales to a limited number of customers. The Company's largest customers change from period to period as large thin-film disk production facilities are completed and new projects are initiated. Matsubo, the Company's Japanese distributor, Seagate Technology ("Seagate") and HMT Technology accounted for 32%, 32% and 13%, respectively, of the Company's total net revenues in 1996; Seagate, HMT Technology, and Matsubo accounted for 40%, 20% and 17%, respectively, of the Company's total net revenues in 1995; and Trace Storage Technology, Matsubo, Seagate, Varian Associates and Komag accounted for 25%, 15%, 13%, 12% and 10%, respectively, of the Company's total net revenues during 1994.

The Company expects that sales of its products to relatively few customers will continue to account for a high percentage of its net revenues in the foreseeable future. For example, 60% of the Company's backlog at June 28, 1997 was represented by orders from three customers for disk sputtering systems, with each representing 10% or more of the Company's backlog at June 28, 1997. None of the Company's customers has entered into a long-term agreement requiring it to purchase the Company's products. As purchases related to a particular new or expanded fabrication facility are completed, sales to that customer may decrease sharply or cease altogether. If completed contracts are not replaced on a timely basis by new orders from the same or other customers, the Company's net revenues could be adversely affected. The loss of a significant customer, any reduction in orders from any significant customer or the cancellation of a significant order from a customer, including reductions or cancellations due to customer departures from recent buying patterns, financial difficulties of a customer or market, economic or competitive conditions in the disk drive industry, could materially adversely affect the Company's business, financial condition and results of operations.

Limited Number of Opportunities

The Company's business depends upon capital expenditures by manufacturers of thin-film disks, of which there are a limited number worldwide. According to a April 1997 report by TrendFocus, an independent market research firm, as of the end of 1996 there were 231 installed disk sputtering lines (sputtering systems and related equipment such as plating, polishing, texturing, lubrication and test equipment as well as related handling equipment) worldwide and only 15 companies in the world with five or more installed disk sputtering lines. Therefore, winning or losing an order from any particular customer could significantly affect the Company's operating results. In addition, the Company's opportunities to sell its systems are further limited by the fact that some of the manufacturers of thin-film disks have adopted an in-line approach as opposed to the Company's static approach to thin-film disk manufacturing. These manufacturers have invested significant amounts of capital in their in-line systems, and there may be significant resistance to change to a static approach in the future. At times the Company has derived a significant proportion of its net revenues from sales of its 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. Consequently, only a limited number of opportunities for the Company to sell its systems may exist at any given time.

Rapid Technological Change; New Products

The disk drive industry in general, and the thin-film disk manufacturing industry in particular, are characterized by rapid technological change and evolving industry standards. As a result, the Company must continue to enhance its existing systems and to develop and manufacture new systems with improved capabilities. This has required and will continue to require substantial investments by the Company 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.

Changes in the manufacturing processes for thin-film disks could also have a material adverse effect on the Company's business, financial condition and results of operations. The Company anticipates continued 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 data storage 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 thinfilm disks as a storage medium.

The Company has expended significant amounts for research and development for its disk sputtering systems, flat panel display manufacturing equipment and other new products under development, such as laser-texturing equipment and electro-optical products. In July of 1997 the Company terminated its program to develop a laser-texturing system for thin-film disks for disk drives.

The Company's success in developing and selling enhanced disk sputtering systems and other new products 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 the requirements for the continuously evolving disk drive industry approximately two or more years 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.

Flat Panel Display Manufacturing Equipment Risks

In 1996, the Company spent approximately $5.3 million on various programs to fund the development of equipment for use in the FPD industry, approximately 59% of which was paid for by the Company's development partners. In exchange for certain development funding, the Company has granted to one of its development partners the exclusive rights to manufacture and market the Company's FPD sputtering systems in Japan. As of December 31, 1996, all of the approximately $5.5 million advanced by the Company's development partner had been applied to qualifying costs. The Company has limited experience in the development, manufacture, sale and marketing of FPD manufacturing equipment, having sold two rapid thermal processing ("RTP") systems to date and having not yet completed development of its FPD sputtering system. Although during the first quarter of 1997 the Company received its first order for the design and delivery of a scaled up version of its D-STAR FPD sputtering machine, there can be no assurance that the market for FPD manufacturing equipment targeted by the Company will develop as quickly or to the degree the Company currently anticipates, or that the Company's proposed FPD manufacturing equipment will achieve customer acceptance or that the Company will achieve any net revenues from the sale of its proposed FPD manufacturing equipment. There can be no assurance the Company will receive additional customer sponsored research and development funding in the future. The failure to receive additional customer sponsored research and development funds could result in the Company internally funding the development of such FPD manufacturing equipment, and the costs of such research and development may have a material adverse effect on the Company's business, financial condition and results of operations. There can be no assurance that the Company in any event will continue to fund research and development in the FPD area.

Leverage

In connection with the sale of the Convertible Notes, the Company incurred approximately $57.5 million in indebtedness which resulted in a substantial increase in the Company's ratio of long-term debt to total capitalization (shareholders' equity plus long-term debt). The ratio at June 28, 1997 and December 31, 1996 was approximately 59.1% and 2.1%, 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.

Management of Expanding Operations

The Company has recently experienced a period of rapid expansion in its operations that has placed, and could continue to place, a significant strain on the Company's management and other resources. The Company's ability to manage its expanding operations effectively will require it to continue to improve its operational, financial, and management information systems, and to train, motivate and manage its employees. If the Company's management is unable to manage its expanding operations effectively, the Company's results of operations could be adversely affected.

The Company's operating results will depend in significant part upon its ability to retain and attract qualified management, engineering, marketing, customer support and sales personnel. Competition for such personnel is intense and the Company has difficulties attracting such personnel, 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 the 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.

Manufacturing Risks

The Company's systems have a large number of components and are highly complex. The Company may experience delays and technical and manufacturing difficulties in future introductions or volume production of new systems or enhancements. 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 or enhancements or to manufacture and ship these systems or enhancements 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. Any of such events could materially adversely affect the Company's business, financial condition and results of operations. Due to recent increases in demand, the average time between order and shipment of the Company's systems may increase substantially in the future. The Company's ability to quickly increase its manufacturing capacity in response to short-term increases in demand could be limited given the complexity of the manufacturing process, the lengthy lead times necessary to obtain critical components and manufacturing space and the need for highly skilled personnel. The failure of the Company to satisfy any such short-term increases in demand and to keep pace with customer demand would lead to further extensions of delivery times, which could deter customers from placing additional orders, and could adversely affect product quality, which could have a materially adverse effect on the Company's business, financial condition and results of operations.

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. The Company has implemented a key supplier program in which it appoints certain key vendors as sole suppliers for certain parts with the goal of improving response time and reducing costs. In addition, the Company makes extensive use of suppliers serving the semiconductor equipment business and such suppliers may choose to give priority to their semiconductor equipment customers that are much larger than the Company. Any prolonged inability to obtain adequate deliveries could require the Company to pay more for inventory, parts and other supplies, seek alternative sources of supply, delay its ability to ship its products and damage relationships with current and prospective customers. Any such delay or damage could have a material adverse effect on the Company's business, financial condition and results of operations.

The Company conducts substantially all of its manufacturing activities at its leased facilities in Santa Clara and Los Gatos, California. The Company's Santa Clara and Los Gatos facilities are located in a seismically active area. A major catastrophe (such as an earthquake or other natural disaster) could result in a prolonged interruption of the Company's business.

Acquisitions

The Company's business strategy includes acquiring related businesses, products or technologies. The Company completed three acquisitions during 1996 and expects that it may pursue additional acquisitions in the future. Any future acquisition may result in potentially dilutive issuance of equity securities, the write-off of in-process research and development, the incurrence of debt and contingent liabilities and amortization expense related to intangible assets acquired, any of which could materially adversely affect the Company's business, financial condition and results of operations. In particular, the Company will not be able to use the "pooling of interests" method of accounting due to a shareholder being greater than a 50% holder of the Company's Common Stock prior to the Company's initial public offering, in connection with any acquisition consummated prior to November 21, 1997 and the Company will therefore be required to amortize any intangible assets acquired in connection with any acquisition consummated during that period.

The Company incurred a charge to operations of $5.8 million in the second quarter of 1996 to reflect the purchase of in-process research and development related to the two acquisitions completed in that quarter. In addition, the Company is amortizing intangible assets of approximately $8.8 million of costs relating to the three acquisitions completed in 1996. The amortization period for such costs is over the useful lives, which range from two years to seven years. Additionally, unanticipated expenses may be incurred relating to the integration of technologies and 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, the potential loss of the acquired company's key employees as well as the costs associated with completing the acquisition and integrating the acquired company.

Risks Associated With International Sales and Operations

Sales to customers in countries other than the United States accounted for 41%, 20% and 40% of revenues in 1996, 1995 and 1994, respectively. The Company anticipates that international sales will continue to account for a substantial portion of net revenues in the future. In order to effectively service customers located in Singapore and the surrounding region, the Company has established sales and service operations in Singapore and Taiwan. 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. 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 been denominated in United States dollars, such sales and expenses may not 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.

Patents and Other Intellectual Property

The Company currently has 23 patents issued in the United States and 1 patent issued in Japan, and has pending patent applications in the United States and foreign countries. Of the 23 US patents, 7 relate to sputtering, 10 relate to RTP, 1 relates to lubrication systems and 5 relate to other areas not in Intevac's mainstream business. In addition, the Company has the right to utilize certain patents under licensing arrangements with Litton Industries, Varian Associates, Stanford University, Lawrence Livermore Laboratories and Alum Rock Technology. 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 amounts of 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 from the Company's discontinued night vision business. Although the Company believes it will have no material liability under these contracts, there can be no assurance that the resolution of the claims by Rockwell with the Federal government will not have a material adverse effect on the Company's business, operating results and financial condition. In the first quarter of 1997, Rockwell's patent in suit was held invalid. Rockwell has appealed that decision. The issues are currently being briefed before the appellate court.

There can be no assurance that other 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.

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.

Dependence on Key Employees

The Company's operating results will depend significantly upon the continued contributions of its officers and key management, engineering, marketing, customer support and sales personnel, many of whom would be difficult to replace. The Company does not have an employment agreement with any of its employees or maintain key person life insurance with respect to any employee. The loss of any key employee could have a material adverse effect on the Company's business, financial condition and results of operations. Employees of the Company are currently required to enter into a confidentiality agreement as a condition of their employment. However, these agreements do not expressly prohibit the employees from competing with the Company after leaving its employ.

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

The Company's annual meeting of shareholders was held on May 15, 1997. The following actions were taken at this meeting:

	AFFIRMATIVE VOTES	NEGATIVE VOTES	VOTES WITHHELD	ABSTENTIONS AND BROKER VOTES
(a) Election of Directors				
Norman H. Pond	9,338,884	11,559	--	3,182,141
Edward Durbin	9,336,384	14,059	--	3,182,141
Robert D. Hempstead	9,338,884	11,559	--	3,182,141
David N. Lambeth	9,336,884	13,559	--	3,182,141
H. Joseph Smead	9,338,264	12,179	--	3,182,141
(b) Approval of an amendment to the Company's Employee Stock Purchase Plan	8,926,624	372,980	--	3,232,980
(c) Ratification of Ernst & Young as independent auditors	9,348,893	100	--	3,183,591

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) The following exhibits are filed herewith:

EXHIBIT NUMBER	DESCRIPTION
**2.1	Stock Purchase Agreement by and among Lotus Technologies, Inc., Lewis Lipton, Dennis Stark, Steve Romine and Intevac, Inc., dated June 6, 1996
*3.1	Amended and Restated Articles of Incorporation of the Registrant
*3.2	Bylaws of the Registrant
***4.2	Indenture, dated as of February 15, 1997, between the Company and State Street Bank and Trust Company of California, N.A. as Trustee, including the form of the Convertible Notes
***4.3	Registration Agreement, dated as of February 15, 1997, among the Company, Salomon Brothers Inc., Robertson, Stephens & Company LLC and Hambrecht & Quist LLC
10.1	Amendment to Line of Credit Agreement dated May 15, 1997
10.2	Amendment to Line of Credit Agreement dated July 17, 1997
11.1	Computation of Net Income Per Share
27.1	Financial Data Schedule

* Previously filed as an exhibit to the Registration Statement on Form S-1 (No. 33-97806).

** Previously filed as an exhibit to the Registration Statement on Form S-1 (No. 333-05531).

*** Previously filed as an exhibit to the Registration Statement on Form S-3 (No. 333-24275).

(b) Reports on Form 8-K:

None.

SIGNATURES

Pursuant to the requirements of the Securities and 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 12, 1997	*By: /s/ NORMAN H. POND* ------------------------------------ *Norman H. Pond* *Chairman of the Board, President and Chief Executive Officer (Principal Executive Officer)*
Date: August 12, 1997	*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	
10.1	Amendment to Line of Credit Agreement dated May 15, 1997
10.2	Amendment to Line of Credit Agreement dated July 17, 1997
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27.1	Financial Data Schedule

EXHIBIT 10.1

[WELLS FARGO LETTERHEAD]

May 15, 1997

Intevac, Inc.
3560 Bassett Street
Santa Clara CA 95054

Gentlemen:

This letter is to confirm the changes agreed upon between Wells Fargo Bank, National Association ("Bank") and Intevac, Inc. ("Borrower") to the terms and conditions of that certain letter agreement between Bank and Borrower dated as of April 30, 1997, as amended from time to time (the "Agreement"). For valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Bank and Borrower hereby agree that the Agreement shall be amended as follows to reflect said changes.

1. Paragraph I.1(b) shall be renumbered to Paragraph I.1(c).

2. The following is hereby added to the Agreement as new Paragraph 1.1(b):

"(b) Letter of Credit Subfeature. As a subfeature under the Line of Credit, Bank agrees from time to time during the term thereof to issue standby letters of credit for the account of Borrower to finance Borrower's acquisitions of business operations (each, a "Letter of Credit" and collectively, "Letters of Credit"); provided however, that the form and substance of each Letter of Credit shall be subject to approval by Bank, in its sole discretion; and provided further, that the aggregate undrawn amount of all outstanding Letters of Credit shall not at any time exceed Ten Million Dollars ($10,000,000.00). No Letter of Credit shall have an expiration date subsequent to the maturity date of the Line of Credit. The undrawn amount of all Letters of Credit shall be reserved under the Line of Credit and shall not be available for borrowings thereunder. Each Letter of Credit shall be subject to the additional terms and conditions of the Letter of Credit Agreement and related documents, if any, required by Bank in connection with the issuance thereof. Each draft paid by Bank under a Letter of Credit shall be deemed an advance under the Line of Credit and shall be repaid by Borrower in accordance with the terms and conditions of this letter applicable to such advances; provided however, that if advances under the Line of Credit are not available, for any reason, at the time any draft is paid by Bank, then Borrower shall immediately pay to Bank the full amount of such draft, together with interest thereon from the date such amount is paid by Bank to the date such amount is fully repaid by Borrower, at the rate of interest applicable to advances under the Line of Credit. In such event Borrower agrees that Bank, in its sole discretion, may debit any demand deposit account maintained by Borrower with Bank for the amount of any such draft."

3. The following is hereby added to the Agreement as Paragraph II.4:

"4. Letter of Credit Fees. Borrower shall pay to Bank fees upon the issuance of each Letter of Credit, upon the payment or negotiation by Bank of each draft under any Letter of Credit and upon the occurrence of any other activity with respect to any Letter of Credit (including without limitation, the transfer, amendment or cancellation of any Letter of Credit) determined in accordance with Bank's standard fees and charges then in effect for such activity."

4. Except as specifically provided herein, all terms and conditions of the Agreement remain in full force and effect, without waiver or modification. All terms defined in the Agreement shall have the same meaning when used herein. This letter and the Agreement shall be read together, as one document.

5. Borrower hereby remakes all representations and warranties contained in the Agreement and reaffirms all covenants set forth therein. Borrower further certifies that as of the date of Borrower's acknowledgment set forth below there exists no default or defined event of default under the Agreement or any promissory note or other contract, instrument or document executed in connection therewith, nor any condition, act or event

which with the giving of notice or the passage of time or both would constitute such a default or defined event of default.

Your acknowledgment of this letter shall constitute acceptance of the foregoing terms and conditions.

Sincerely,

WELLS FARGO BANK,
NATIONAL ASSOCIATION

By:

John Adams Vice President

Acknowledged and accepted as of 5-27-97:

INTEVAC, INC.

By: /s/ CHARLES B. EDDY III

Charles B. Eddy III
Chief Financial Officer

EXHIBIT 10.2

[WELLS FARGO BANK LETTERHEAD]

July 17, 1997

INTEVAC, INC.
3560 Bassett Street
Santa Clara, CA 95054

Gentlemen:

This letter is to confirm the changes agreed upon between Wells Fargo Bank, National Association ("Bank") and INTEVAC, INC. ("Borrower") to the terms and conditions of that certain letter agreement between Bank and Borrower dated as of April 30, 1997, as amended from time to time (the "Agreement"). For valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Bank and Borrower hereby agree that the Agreement shall be amended as follows to reflect said changes.

1. Paragraph V.13. Is hereby deleted in its entirety, and the following substituted therefor:

"Not declare or pay any dividend or distribution either in cash, stock or any other property on Borrower's stock now or hereafter outstanding, nor redeem, retire, repurchase or otherwise acquire any shares of any class of Borrower's stock now or hereafter outstanding, except that Borrower may repurchase up to 350,000 shares of Borrower's common stock not to exceed $10,000,000.00 in aggregate purchase price."

2. Except as specifically provided herein, all terms and conditions of the Agreement remain in full force and effect, without waiver or modification. All terms defined in the Agreement shall have the same meaning when used herein. This letter and the Agreement shall be read together, as one document.

3. Borrower hereby remakes all representations and warranties contained in the Agreement and reaffirms all covenants set forth therein. Borrower further certifies that as of the date of Borrower's acknowledgment set forth below there exists no default or defined event of default under the Agreement or any promissory note or other contract, instrument or document executed in connection therewith, nor any condition, act or event which with the giving of notice or the passage of time or both would constitute such a default or defined event of default.

Your acknowledgment of this letter shall constitute acceptance of the foregoing terms and conditions.

Sincerely,

WELLS FARGO BANK,
NATIONAL ASSOCIATION

By: /s/ JOHN ADAM

John Adam
Vice President

Acknowledged and accepted as of ______________________, 1997:

INTEVAC, INC.

By: /s/ CHARLES B. EDDY III

Title: Chief Financial Officer

EXHIBIT 11.1

INTEVAC, INC.

COMPUTATION OF NET INCOME PER SHARE
(IN THOUSANDS, EXCEPT PER SHARE DATA)

(UNAUDITED)

	THREE MONTHS ENDED		SIX MONTHS ENDED	
	JUNE 28, 1997	JUNE 29, 1996	JUNE 28, 1997	JUNE 29, 1996
PRIMARY EARNINGS PER SHARE:				
Shares used in Calculation of Net Income Per Share:				
Average common shares outstanding	12,534	12,256	12,519	12,252
Net effect of dilutive stock options	540	--	575	--
Total equivalent common shares	13,074	12,256	13,094	12,252
Net income (loss)	$ 3,577	$ (3,225)	$ 6,993	$ (1,328)
Net income (loss) per share	$ 0.27	$ (0.26)	$ 0.53	$ (0.11)
FULLY DILUTED EARNINGS PER SHARE:				
Shares used in Calculation of Net Income Per Share:				
Average common shares outstanding	12,534	12,256	12,519	12,252
Net effect of dilutive stock options	540	--	575	--
Conversion of convertible debt	2,788	--	1,901	--
Total equivalent common shares	15,862	12,256	14,995	12,252
Net income (loss)	$ 3,577	$ (3,225)	$ 6,993	$ (1,328)
Add interest expense, net of tax effect on convertible debt	563	--	761	--
Adjusted net income (loss)	$ 4,140	$ (3,225)	$ 7,754	$ (1,328)
Net income (loss) per share	$ 0.26	$ (0.26)	$ 0.52	$ (0.11)

ARTICLE 5

THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONDENSED CONSOLIDATED BALANCE SHEET AT JUNE 28, 1997 (UNAUDITED) AND THE CONDENSED CONSOLIDATED STATEMENT OF INCOME (UNAUDITED) FOR THE 6 MONTHS ENDED JUNE 28, 1997 AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS

MULTIPLIER: 1,000

PERIOD TYPE	6 MOS
FISCAL YEAR END	DEC 31 1997
PERIOD START	JAN 01 1997
PERIOD END	JUN 28 1997
CASH	456
SECURITIES	69,013
RECEIVABLES	16,697
ALLOWANCES	1,303
INVENTORY	26,207
CURRENT ASSETS	114,002
PP&E	16,706
DEPRECIATION	4,977
TOTAL ASSETS	139,131
CURRENT LIABILITIES	38,116
BONDS	59,455
PREFERRED MANDATORY	0
PREFERRED	0
COMMON	17,172
OTHER SE	23,982
TOTAL LIABILITY AND EQUITY	139,131
SALES	64,904
TOTAL REVENUES	64,904
CGS	44,619
TOTAL COSTS	44,619
OTHER EXPENSES	9,559
LOSS PROVISION	324
INTEREST EXPENSE	1,448
INCOME PRETAX	10,927
INCOME TAX	3,934
INCOME CONTINUING	6,993
DISCONTINUED	0
EXTRAORDINARY	0
CHANGES	0
NET INCOME	6,993
EPS PRIMARY	0.53
EPS DILUTED	0.52

End of Filing