INTEVAC INC
Form 10-Q
May 08, 2008

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SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

Form 10-Q

(Mark One)

þ	**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the quarterly period ended March 29, 2008
	or
o	**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
	For the transition period from to

Commission file number 0-26946

INTEVAC, INC.
(Exact name of registrant as specified in its charter)

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

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

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

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

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

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

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

APPLICABLE ONLY TO CORPORATE ISSUERS:

On May 2, 2008, 21,693,082 shares of the Registrant s Common Stock, $0.001 par value, were outstanding.

INTEVAC, INC.

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PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

INTEVAC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	March 29, 2008	December 31, 2007
	(Unaudited) (In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 27,275	$ 27,673
Short-term investments	18,888	110,985
Trade and other accounts receivable, net of allowances of $57 at both March 29, 2008 and December 31, 2007	22,831	14,142
Inventories	22,203	22,133
Prepaid expenses and other current assets	3,266	4,162
Deferred tax assets	4,450	3,609
Total current assets	98,913	182,704
Property, plant and equipment, net	15,604	15,402
Long-term investments	78,788	2,009
Goodwill	7,905	7,905
Other intangible assets, net	1,714	1,782
Deferred income taxes and other long term assets	6,317	5,611
Total assets	$ 209,241	$ 215,413
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Note payable	$ 1,929	$ 1,992
Accounts payable	6,825	7,678
Accrued payroll and related liabilities	3,478	8,610
Other accrued liabilities	5,185	5,454
Customer advances	3,910	4,340
Total current liabilities	21,327	28,074
Other long-term liabilities	190	278
Long-term note payable		1,898
Shareholders equity:		
Common stock, $0.001 par value	22	22

Additional paid-in capital	122,389	120,056
Accumulated other comprehensive income (loss)	(764)	571
Retained earnings	66,077	64,514
Total shareholders equity	187,724	185,163
Total liabilities and shareholders equity	$ 209,241	$ 215,413

Note: Amounts as of December 31, 2007 are derived from the December 31, 2007 audited consolidated financial statements.

See accompanying notes.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(Unaudited) (In thousands, except per share amounts)	
Net revenues:		
Systems and components	$ 29,014	$ 73,593
Technology development	4,161	2,781
Total net revenues	33,175	76,374
Cost of net revenues:		
Systems and components	15,169	42,129
Technology development	2,474	1,507
Inventory provisions	221	(44)
Total cost of net revenues	17,864	43,592
Gross profit	15,311	32,782
Operating expenses:		
Research and development	9,388	12,192
Selling, general and administrative	7,064	7,513
Total operating expenses	16,452	19,705
Operating income (loss)	(1,141)	13,077
Interest expense	(65)	(46)
Interest income and other, net	1,476	1,366
Income before income taxes	270	14,397
Provision for (benefit from) income taxes	(1,293)	4,552
Net income	$ 1,563	$ 9,845
Other comprehensive income (loss):		
Unrealized losses on securities held as available for sale	(1,567)	
Foreign currency translation adjustments	232	21
Total comprehensive income	$ 228	$ 9,866
Basic income per share:		
Net income	$ 0.07	$ 0.46

Shares used in per share amounts	21,647	21,293
Diluted income per share:		
Net income	$ 0.07	$ 0.44
Shares used in per share amounts	22,053	22,188

See accompanying notes.

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INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(Unaudited) (In thousands)	
Operating activities		
Net income	$ 1,563	$ 9,845
Adjustments to reconcile net income to net cash and cash equivalents provided by (used in) operating activities:		
Depreciation and amortization	1,085	1,163
Inventory provisions	221	(44)
Equity-based compensation	1,527	1,357
Deferred income taxes	(298)	
Changes in operating assets and liabilities	(15,921)	894
Total adjustments	(13,386)	3,370
Net cash and cash equivalents provided by (used in) operating activities	(11,823)	13,215
Investing activities		
Purchases of investments	(7,000)	(43,700)
Proceeds from sales and maturities of investments	20,900	23,500
Acquisition of DeltaNu LLC, net of cash acquired		(2,084)
Purchases of leasehold improvements and equipment	(1,327)	(1,856)
Net cash and cash equivalents provided by (used in) investing activities	12,573	(24,140)
Financing activities		
Net proceeds from issuance of common stock	804	1,645
Payment of note payable	(2,000)	
Tax benefit from equity-based compensation		645
Net cash and cash equivalents provided by (used in) financing activities	(1,196)	2,290
Effect of exchange rate changes on cash	48	(9)
Net decrease in cash and cash equivalents	(398)	(8,644)
Cash and cash equivalents at beginning of period	27,673	39,440
Cash and cash equivalents at end of period	$ 27,275	$ 30,796
Supplemental Schedule of Cash Flow Information		
Cash paid (received) for:		
Income taxes	$	$ 1,500
Income tax refund	(1,135)	

Other non-cash changes		
Notes payable issued for the acquisition of DeltaNu, LLC	$	$ 3,719

See accompanying notes.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Business Activities and Basis of Presentation

Intevac s business consists of two reportable segments:

Equipment: Intevac is a leader in the design, manufacture and marketing of high-productivity lean manufacturing systems and has been producing Lean Thinking platforms since 1994. We are the leading supplier of magnetic media sputtering equipment to the hard disk drive industry and offer leading-edge, high-productivity etch systems to the semiconductor industry.

Imaging Instrumentation: Intevac is a leader in the development of compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and the optical analysis of materials. We provide sensors, cameras and systems for commercial applications in the inspection, medical, scientific and security industries and for government applications such as night vision and long-range target identification.

The majority of our revenue is currently derived from our Equipment business, and we expect that the majority of our revenues for the next several years will continue to be derived from our Equipment business.

The financial information at March 29, 2008 and for the three-month periods ended March 29, 2008 and March 31, 2007 is unaudited, but includes all adjustments (consisting only of normal recurring accruals) that we consider necessary for a fair presentation of the financial information set forth herein, in accordance with accounting principles generally accepted in the United States of America (U.S. GAAP) for interim financial information, the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, it does not include all of the information and footnotes required by U.S. GAAP for annual financial statements. For further information, refer to the Consolidated Financial Statements and footnotes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2007.

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and reported amounts of revenue and expenses during the reporting period. Actual results inevitably will differ from those estimates, and such differences may be material to the financial statements.

The results for the three-month period ended March 29, 2008 are not considered indicative of the results to be expected for any future period or for the entire year.

Intevac®, LIVAR®, D-STAR®, Lean Etch™, 200 Lean®, AccuLuber™, ExamineR™, and MOSIR®, among others, are our trademarks.

2. Concentrations

Historically, a significant portion of our revenues in any particular period has been attributable to sales to a limited number of customers. Our largest customers tend to change from period to period.

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

3. New Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standard No. 157, Fair Value Measurements (SFAS 157). SFAS 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. FAS 157 is effective for fiscal years beginning after November 15, 2007 for financial assets and liabilities, as well as for any other assets and liabilities that are carried at fair value on a recurring basis in financial statements. In November 2007, the FASB provided a one year deferral for the implementation of FAS 157 for other nonfinancial assets and

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

liabilities. The adoption of this standard did not have a material impact on our financial condition, results of operations or cash flows.

In February 2008, the FASB issued FASB Staff Position SFAS 157-1, Application of FASB Statement No. 157 to FASB Statement No. 13 and Other Accounting Pronouncements That Address Fair Value Measurements for Purposes of Lease Classification or Measurement under Statement 13 (FSP FAS 157-1). FSP FAS 157-1 defers the effective date of SFAS 157 for all non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis. FSP FAS 157-1 also excludes from the scope of SFAS 157 certain leasing transactions accounted for under SFAS No. 13, Accounting for Leases . The adoption of FSP FAS 157-1 did not have a material impact on our financial condition, results of operations or cash flows.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The fair value option established by SFAS 159 permits all entities to choose to measure eligible items at fair value at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. We chose not to apply the provisions of SFAS 159.

In December 2007 the FASB issued Statement of Financial Accounting Standards No. 141(R), Business Combinations (SFAS 141R). SFAS 141R retains the fundamental acquisition method of accounting established in Statement 141; however, among other things, SFAS 141R requires recognition of assets and liabilities of non-controlling interests acquired, fair value measurement of consideration and contingent consideration, expense recognition for transaction costs and certain integration costs, recognition of the fair value of contingencies, and adjustments to income tax expense for changes in an acquirer s existing valuation allowances or uncertain tax positions that result from the business combination. SFAS 141R is effective for annual reporting periods beginning after December 15, 2008 and shall be applied prospectively. We do not expect the adoption of this standard to have a material impact on our financial condition , results of operations or cash flows.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities An Amendment of FASB Statement No. 133 (SFAS 161). SFAS 161 enhances required disclosures regarding derivatives and hedging activities. SFAS is effective for fiscal years and interim periods beginning after November 15, 2008. We are currently evaluating the impact of adopting this standard.

4. Inventories

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

	March 29, 2008	December 31, 2007
	(In thousands)	
Raw materials	$ 12,733	$ 13,666
Work-in-progress	6,181	6,191

Finished goods	3,289	2,276
	$ 22,203	$ 22,133

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

Inventory reserves included in the above numbers were $7.7 million and $7.8 million at March 29, 2008 and December 31, 2007, respectively. Each quarter, we analyze our inventory (raw materials, work-in-progress and finished goods) against the forecast demand for the next 12 months. Raw materials with no forecast requirements in

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

that period are considered excess and inventory provisions are established to write those items down to zero net book value. Work-in-progress and finished goods inventories with no forecast requirements in that period are typically written down to the lower of cost or market. During this process, some inventory is identified as having no future use or value to us and is disposed of against the reserves.

The following table displays the activity in the inventory reserve account for the three-month periods ending March 29, 2008 and March 31, 2007:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Beginning balance	$ 7,750	$ 9,128
Provisions in cost of sales	221	(44)
Provisions for refurbishment of consigned products	66	6
Disposals of inventory	(248)	(547)
Miscellaneous adjustments	(106)	
Ending balance	$ 7,683	$ 8,543

5. Stock-Based Compensation

At March 29, 2008, we had stock-based awards outstanding under the 2004 Equity Incentive Plan (the 2004 Plan) and the 2003 Employee Stock Purchase Plan (the ESPP). Our shareholders approved both of these plans.

The 2004 Plan permits the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, performance units and performance shares. During the three months ended March 29, 2008, we granted 18,250 stock options with an estimated total grant-date fair value of $114,000. Of this amount, we estimated that the stock-based compensation for the awards not expected to vest was $26,000.

The ESPP provides that eligible employees may purchase our common stock through payroll deductions at a price equal to 85% of the lower of the fair market value at the beginning of the applicable offering period or at the end of each applicable purchase period. Offering periods are generally two years in length, and consist of a series of six-month purchase intervals. Eligible employees may join the ESPP at the beginning of any six-month purchase interval. During the three months ended March 29, 2008, we granted purchase rights with an estimated total grant-date value of $408,000.

Compensation Expense

The effect of recording stock-based compensation for the three-month periods ended March 29, 2008 and March 31, 2007 was as follows:

	Three Months Ended	
	March 29, 2008	**March 31, 2007**
Stock-based compensation by type of award:		
Stock options	$ 1,325	$ 1,145
Employee stock purchase plan	202	213
Amounts capitalized as inventory (released to cost of sales)	69	(4)
Total stock-based compensation	1,596	1,354
Tax effect on stock-based compensation	(626)	(428)
Net effect on net income	$ 970	$ 926
Effect on earnings per share:		
Basic	$ 0.04	$ 0.04
Diluted	$ 0.04	$ 0.04

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Approximately $111,000 and $73,000 of stock-based compensation was capitalized as inventory at March 29, 2008 and March 31, 2007, respectively.

Valuation Assumptions

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

The weighted-average estimated value of employee stock options granted during the three months ended March 29, 2008 and March 31, 2007 was $6.25 per share and $15.91 per share, respectively. The weighted-average estimated fair value of employee stock purchase rights granted pursuant to the ESPP during the three months ended March 29, 2008 and March 31, 2007 was $5.61 per share and $10.54 per share, respectively. The fair value of each option and employee stock purchase right grant is estimated on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	Three Months Ended	
	March 29, 2008	**March 31, 2007**
Stock Options:		
Expected volatility	65.18%	67.42%
Risk free interest rate	2.33%	4.49%
Expected term of options (in years)	4.5	4.5
Dividend yield	None	None
Stock Purchase Rights:		
Expected volatility	61.26%	63.48%
Risk free interest rate	1.5%	4.84%
Expected term of purchase rights (in years)	1.3	1.0
Dividend yield	None	None

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

As the stock-based compensation expense recognized in the Condensed Consolidated Statement of Operations is based on awards ultimately expected to vest, such amount has been reduced for estimated forfeitures. Statement of Financial Accounting Standards No. 123(R) requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Forfeitures were estimated based on our historical experience.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock Plan Activity

2004 Equity Incentive Plan

A summary of activity under the above captioned plan is as follows:

	Shares	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)	Aggregate Intrinsic Value
Options outstanding at December 31, 2007	2,587,854	$ 13.37	7.64	
Options granted	18,250	$ 11.79		
Options forfeited	(48,774)	$ 18.97		
Options exercised	(7,750)	$ 8.38		
Options outstanding at March 29, 2008	2,549,580	$ 13.27	7.53	$ 6,657,122
Vested and expected to vest at March 29, 2008	2,191,776	$ 12.91	7.37	$ 6,232,141
Options exercisable at March 29, 2008	969,050	$ 10.23	6.03	$ 4,454,637
Available to grant at March 29, 2008	670,377			

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing stock price of $13.26 as of March 29, 2008, which would have been received by the option holders had all options holders exercised their options as of that date. During the three months ended March 29, 2008 and March 31, 2007 the aggregate intrinsic value of options exercised under our Equity Incentive Plan was $24,000 and $3.6 million, respectively, determined as of the date of option exercise.

As of March 29, 2008, the unrecorded deferred stock-based compensation balance related to stock options was $8.7 million and will be recognized over an estimated weighted average recognition period of 1.49 years. The recognition period is based on the expected term of the option, which is defined as the period from grant date to exercise date.

2003 Employee Stock Purchase Plan

A summary of activity under the above captioned plan is as follows:

	Weighted Average Remaining	Aggregate Intrinsic

	Shares	Weighted Average Exercise Price	Contractual Term (Years)	Value
Purchase rights outstanding at March 29, 2008	308,291	$ 9.72	1.07	$ 1,091,350

The aggregate intrinsic value in the table above represents the total pretax intrinsic value, based on our closing stock price of $13.26 as of March 29, 2008, which would have been received by the purchase right holders had all purchase rights been exercised as of that date. During the three months ended March 29, 2008 and March 31, 2007 the aggregate intrinsic value of shares purchased under our ESPP was $130,000 and $193,000, respectively, determined as of the date of purchase.

During the three months ended March 29, 2008, 79,810 shares were purchased at a price of $9.26 per share. At March 29, 2008, there were 218,109 shares available to be issued under the ESPP.

As of March 29, 2008, the unrecorded deferred stock-based compensation balance related to purchase rights was $1.0 million and will be recognized over an estimated weighted average recognition period of 0.7 years. The

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

recognition period is based on the expected term of the purchase right, which is defined as the period from grant date to expiration of the offering period.

6. Business Combinations

On January 31, 2007, we completed the acquisition of the assets and certain liabilities of DeltaNu, LLC (DeltaNu) for a total purchase price of $6 million. The purchase price was comprised of $2 million cash paid at the close of the acquisition and $2 million due on each of January 31, 2008 and January 31, 2009, which is in the form of a note. These notes do not bear interest. Interest is imputed, and the related Notes Payable is recorded at a discount in the accompanying Condensed Consolidated Balance Sheet. As a result of the discount on the notes, the total allocated purchase price is $5.8 million. DeltaNu is a Laramie, Wyoming company specializing in small footprint and handheld Raman spectrometry instruments.

On November 9, 2007, we completed the acquisition of the assets and certain liabilities of Creative Display Systems, LLC (CDS) for a total purchase price of $6 million cash paid at the close of the acquisition. CDS is a Carlsbad, California company specializing in high-performance micro-display products for near-eye and portable applications in defense and commercial markets.

We accounted for both acquisitions as taxable purchase transactions and, accordingly, the purchase prices have been allocated to tangible assets, liabilities assumed, and identifiable intangible assets acquired based on their estimated fair values on the acquisition date. The fair value assigned to identifiable intangible assets acquired is determined using the income approach, which discounts expected future cash flows to present value using estimates and assumptions determined by management. Purchased intangible assets are amortized on a straight-line basis over their respective useful lives.

In accordance with SFAS No. 141, we allocated the excess of the cost of the acquired entities over the net amounts of assets acquired and liabilities assumed to goodwill. At March 29, 2008, we had recorded $7.9 million of goodwill on our Consolidated Balance Sheet. In accordance with SFAS No. 142, goodwill is not amortized. Instead, it is tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill may be impaired. We did not record any impairment of goodwill during the three months ended March 29, 2008.

Total amortization expense of purchased intangibles for the three months ended March 29, 2008 was $68,000. Future amortization expense for the existing amortizable intangible assets for the years ending December 31 is as follows:

2008 (remaining 9 months)	$ 267,000
2009	152,000
2010	143,000
2011	132,000
2012	132,000
Beyond	768,000
Total	$ 1,594,000

The results of operations for the acquired businesses have been included in our consolidated statements of operations for the periods subsequent to our acquisition of DeltaNu and CDS, respectively. The results of operations for DeltaNu and CDS for periods prior to their acquisition were not material to our consolidated statements of operations and, accordingly, pro forma financial information has not been presented.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

7. Warranty

We provide for the estimated cost of warranty when revenue is recognized. Our warranty is per contract terms and for our systems the warranty typically ranges between 12 and 24 months from customer acceptance. For systems sold through our distributor, we offer a 3 month warranty, where the remainder of any warranty period is the responsibility of the distributor. During the warranty period any defective non-consumable parts are replaced and installed at no charge to the customer. The warranty period on consumable parts is limited to their reasonable usable lives. We use estimated repair or replacement costs along with our historical warranty experience to determine our warranty obligation. We exercise judgment in determining the underlying estimates. We also provide for estimated retrofit costs, which typically relate to design changes or improvements we identify. On a case-by-case basis, we determine whether or not to retrofit systems in the field at no charge to the customer.

On the Condensed Consolidated Balance Sheet, the short-term portion of the warranty provision is included in other accrued liabilities, while the long-term portion is included in other long-term liabilities. The expense associated with product warranties issued or adjusted is included in cost of net revenues on the Condensed Consolidated Statement of Income and Comprehensive Income.

The following table displays the activity in the warranty provision account for the three-month periods ending March 29, 2008 and March 31, 2007:

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Beginning balance	$ 3,092	$ 5,283
Expenditures incurred under warranties	(674)	(1,235)
Accruals for product warranties issued during the reporting period	435	1,074
Adjustments to previously existing warranty accruals	(275)	107
Ending balance	$ 2,578	$ 5,229

The following table displays the balance sheet classification of the warranty provision account at March 29, 2008 and at December 31, 2007:

	March 29, 2008	December 31, 2007
	(In thousands)	
Other accrued liabilities	$ 2,413	$ 2,814
Other long-term liabilities	165	278

Total warranty provision	$	2,578	$	3,092

8. Guarantees

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

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

9. Cash, Cash Equivalents and Investments

Cash and cash equivalents are comprised of short-term, highly liquid investments with maturities of 90 days or less from the date of purchase. Investments are comprised of both available-for-sale securities, which are recorded at estimated fair value, and held-to-maturity securities, which are carried at amortized cost. Our investments consist principally of highly rated debt instruments with maturities generally between one and twenty-five months. We account for our investments in accordance with Statement of Accounting Standards No. 115 Accounting for Certain Investments in Debt and Equity Securities. Unrealized gains and losses associated with our investments, if any, are reported in stockholder s equity. Cash balances held in foreign bank accounts totaled $3.5 million and $4.3 million at March 29, 2008 and December 31, 2007, respectively. Included in accounts payable is $1.7 million and $2.1 million of book overdraft at March 29, 2008 and December 31, 2007, respectively. The table below presents the amortized principal amount, major security type and maturities for our investments:

	March 29, 2008	December 31, 2007
	(In thousands)	
Amortized Principal Amount:		
Debt securities issued by the US government and its agencies	$ 20,893	$ 29,744
Auction rate securities	76,783	81,450
Corporate debt securities		1,800
Total investments in debt securities	$ 97,676	$ 112,994
Short-term investments	$ 18,888	$ 110,985
Long-term investments	78,788	2,009
Total investments in debt securities	$ 97,676	$ 112,994
Approximate fair value of investments in debt securities	$ 97,802	$ 113,029

As of March 29, 2008, we had $78.4 million par value invested in auction rate securities (ARS). All of our ARS are student loan structured issues, where the loans have been originated under the Department of Education s Federal Family Education Loan Program (FFELP). The principal and interest are 97-98% reinsured by the U.S. Department of Education, the collateral ratios range from 103% to 113%, and there have been no changes to the AAA rating of the securities. Beginning in mid-February, these ARS failed auction due to sell orders exceeding buy orders, primarily driven by the decision of the investment banks to not continue participating in the auctions. As of this date, all of our holdings have experienced at least two failed auctions. Our investments in ARS will not be accessible until a successful auction occurs, they are restructured into a more liquid security, a buyer is found outside of the auction process, or the underlying securities have matured. As a result, we have recorded an unrealized loss for the three months ended March 29, 2008. This unrealized loss was determined in accordance with SFAS 157, which we adopted on January 1, 2008.

As a basis for considering market participant assumptions in fair value measurements, SFAS No. 157 establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The fair value hierarchy gives the highest priority to quoted prices in active markets for identical assets or liabilities (Level 1) and the lowest priority to unobservable inputs (Level 3). Due to the lack of actively traded market data or other observable inputs, the value of our ARS and the resulting unrealized loss was determined using Level 3 hierarchical inputs. These inputs include management s assumptions of pricing by market participants, including assumptions about risk. In accordance with SFAS No. 157, we arrived at the impairment amount through a model where we compared the expected rate of return on our ARS to similar other rates of return which an investor would demand in the market. We discounted the securities over a three-year period, which is reflective of the length of time we anticipate it may take the ARS to become liquid. Comparing the rate of return generated by our ARS portfolio to the rate of return an investor would demand in the market resulted in a valuation

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INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

of 98% for our ARS investments. The reclassification of these securities from current assets to long-term assets was deemed appropriate, as we believe that the ARS market will not become liquid within the next year. Potentially, it could take until the final maturity of the underlying notes (ranging from 23 years to 49 years) to realize these investments recorded value. We currently believe these securities are not permanently impaired, primarily due to the government guarantee of the underlying securities and our ability to hold these securities for the foreseeable future.

Based on our valuation model and an analysis of other-than-temporary impairment factors, we wrote down our ARS investments to an estimated fair value of $76.8 million at March 29, 2008. This write-down resulted in a temporary impairment charge of $1.6 million, which is reflected as unrealized loss within other comprehensive income. We review impairments associated with the above in accordance with Emerging Issues Task Force (EITF) 03-01 and FSP SFAS 115-1 and 124-1, The Meaning of Other-Than-Temporary-Impairment and Its Application to Certain Investments, to determine the classification of the impairment as temporary or other-than-temporary. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders equity. Such an unrealized loss does not reduce net income for the applicable accounting period, because the loss is not viewed as other-than-temporary.

10. Net Income Per Share

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

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Numerator:		
Numerator for diluted earnings per share income available to common stockholders	$ 1,563	$ 9,845
Denominator:		
Denominator for basic earnings per share weighted-average shares	21,647	21,293
Effect of dilutive securities:		
Employee stock compensation(1)	406	895
Dilutive potential common shares	406	895
Denominator for diluted earnings per share adjusted	22,053	22,188

(1) Potentially dilutive securities, consisting of shares issuable upon exercise of employee stock options, are excluded from the calculation of diluted EPS when their effect would be anti-dilutive. The weighted average number of employee stock options excluded for the three-month periods ended March 29, 2008 and March 31, 2007 was 1,597,575 and 249,850 respectively.

11. Segment Reporting

Segment Description

We have two reportable operating segments: Equipment and Imaging Instrumentation. Our Equipment business is a leader in the design, manufacture and marketing of high-productivity lean manufacturing systems and has been producing Lean Thinking platforms since 1994. We are the leading supplier of magnetic media sputtering equipment to the hard disk drive industry and offer leading-edge, high-productivity etch systems to the semiconductor industry. Our Imaging Instrumentation business is a leader in the development of compact, cost-effective, high-sensitivity digital-optical products for the capture and display of low-light images and the optical

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analysis of materials. We provide sensors, cameras and systems for commercial applications in the inspection, medical, scientific and security industries and for government applications such as night vision and long-range target identification.

Included in corporate activities are general corporate expenses, less an allocation of corporate expenses to operating units equal to 3% of net revenues. Assets of corporate activities include unallocated cash and investments, deferred tax assets and other assets.

Segment Profit or Loss and Segment Assets

We evaluate performance and allocate resources based on a number of factors, including profit or loss from operations and future revenue potential. The accounting policies of the reportable segments are the same as those described in the summary of significant accounting policies.

Business Segment Net Revenues

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Equipment	$ 26,973	$ 72,446
Imaging Instrumentation	6,202	3,928
Total	$ 33,175	$ 76,374

Business Segment Profit & Loss

	Three Months Ended	
	March 29, 2008	March 31, 2007
	(In thousands)	
Equipment	$ 496	$ 14,989
Imaging Instrumentation	(821)	(1,600)
Corporate activities	(816)	(312)
Operating income (loss)	(1,141)	13,077
Interest expense	(65)	(46)
Interest income	1,513	1,238
Other income and expense, net	(37)	128

Income before income taxes	$ 270	$ 14,397

Business Segment Net Assets

	March 29, 2008	December 31, 2007
	(In thousands)	
Equipment	$ 44,614	$ 36,637
Imaging Instrumentation	25,745	26,715
Corporate activities	138,882	152,061
Total	$ 209,241	$ 215,413

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Geographic Area Net Trade Revenues

	Three Months Ended	
	March 29, 2008	**March 31, 2007**
	(In thousands)	
United States	$ 6,771	$ 7,000
Asia	25,845	69,004
Europe	559	370
Total	$ 33,175	$ 76,374

12. Income Taxes

For the three months ended March 29, 2008, we accrued income tax using an effective tax rate of (478.9)% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Our tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits, the effect of permanent differences and the geographical composition of our worldwide earnings. Due to the fact that an overall tax benefit is projected for the year based on positive pre-tax earnings, the quarterly effective rate is computed by separately applying an estimated U.S. tax rate to U.S. earnings and an estimated foreign tax to foreign earnings to arrive at an overall effective tax rate for the quarter in accordance with FASB Interpretation No. 18 Accounting for income Taxes in Interim Periods, an interpretations of APB opinion No. 28. Our deferred tax asset of $11.8 million is partially offset by a valuation allowance, resulting in a net deferred tax asset of $9.1 million at March 29, 2008. The valuation allowance is attributable to state temporary differences and deferred research and development credits that are not realizable in 2008.

For the three months ended March 31, 2007, we accrued income tax using an effective tax rate of 31.6% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Our effective tax rate is highly dependent on the availability of tax credits and the geographic composition of our worldwide earnings.

We adopted the provisions of Financial Accounting Standards Board (FASB) Interpretation Number 48, Accounting for Uncertainty in Income Taxes, (FIN 48) on January 1, 2007. As required by FIN 48, which clarifies SFAS No. 109, Accounting for Income Taxes, we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amount recognized in the financial statements is the largest benefit that has a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. At January 1, 2007, we applied FIN 48 to all tax positions for which the statute of limitations remained open and determined there were no material unrecognized tax benefits as of that date. In addition, there have been no material changes in unrecognized benefits since January 1, 2007. As a result, the adoption of FIN 48 did not have an effect on

our financial condition, or results of operation.

We are subject to income taxes in the U.S. federal jurisdiction, and various states and foreign jurisdictions. Tax regulations within each jurisdiction are subject to the interpretation of the related tax laws and regulations and require significant judgment to apply. With few exceptions, we are no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for the years before 2000.

13. Contingencies

On July 7, 2006, we filed a patent infringement lawsuit against Unaxis USA, Inc. (a wholly owned subsidiary of Oerlikon) and its affiliates, Unaxis Balzers AG and Unaxis Balzers, Ltd., in the United States District Court for the Central District of California. Our lawsuit against Unaxis asserts infringement by Unaxis of United States Patent

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6,919,001, which relates to our 200 Lean system. Our complaint seeks monetary damages and an injunction that bars Unaxis from making, using, offering to sell or selling in the United States, or importing into the United States, Unaxis allegedly infringing product. In the suit, we seek damages and a permanent injunction for infringement of the same patent. We believe we have meritorious claims, and we intend to pursue them vigorously.

On September 12, 2006, Unaxis filed a response to our lawsuit in which it asserted non-infringement, invalidity of our patent, inequitable conduct by Intevac, patent misuse by Intevac, and lack of jurisdiction by the court as defenses. Additionally, Unaxis requested a declaratory judgment of patent non-infringement, invalidity and unenforceability; asserted our violation of the California Business and Professional Code; requested that we be enjoined from engaging in any unfair competition; and requested that we be required to pay Unaxis attorney fees. We believe such claims lack merit, and we intend to defend ourselves vigorously.

We replied to Unaxis response on October 3, 2006, denying the assertions of non-infringement, invalidity and unenforceability of the Intevac patent, and denying any unfair competition. With the approval of the Court, we amended our complaint on February 6, 2007 to assert an additional ground for our infringement claim and to add a request for a declaratory judgment of infringement. Unaxis filed a response on February 21, 2007, in which it repeated the assertions of its September 12, 2006 response.

On May 21, 2007, the Court granted Unaxis request to stay the litigation pending reexamination of our United States Patent 6,919,001, after the U.S. Patent Office granted Unaxis February 27, 2007 reexamination request and issued an initial office action rejecting the claims of the patent. The Court also ordered the parties to file a joint report every 120 days to keep it appraised of the reexamination status. Intevac had no input to the initial office action determination by the U.S. Patent Office.

On June 20, 2007, we filed a reply to the initial office action reexamination. Our reply addresses the office action s rejections of the patent s original claims and proposes amended claims that we believe are supported by the original patent s specification. Unaxis responded to our reply, and the U.S. Patent Office is now considering both parties submissions. During the reexamination process, the patent remains valid.

14. Capital Transactions

During the three-month period ending March 29, 2008, we sold stock to our employees under Intevac s Equity Incentive and Employee Stock Purchase Plans. A total of 87,560 shares were issued under these plans, for which we received $804,000.

15. Financial Presentation

Certain prior year amounts in the Condensed Consolidated Financial Statements have been reclassified to conform to 2008 presentation. The Condensed Consolidated Statements of Cash Flows for the period ended March 31, 2007 was reclassified to reflect the year-end 2007 presentation of the cash flow impact of the acquisition of DeltaNu, LLC. The reclassifications had no material effect on total assets, liabilities, equity, revenue, net income (loss) or comprehensive income (loss) previously reported.

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

This Quarterly Report on Form 10-Q contains forward-looking statements, which involve risks and uncertainties. Words such as believes, expects, anticipates and the like indicate forward-looking statements. These forward looking statements include comments related to our shipments, projected revenue recognition, product costs, gross margin, operating expenses, interest income, cash balances and financial results in 2008; our projected customer requirements for new capacity and for technology upgrades for their installed base of our thin-film disk sputtering equipment, and when, and if, our customers will place orders for these products; our Imaging Instrumentation business ability to proliferate its technology into major military weapons programs and to develop and introduce commercial imaging products; the timing of delivery and/or acceptance of the systems and products that comprise our backlog for revenue; and that the auction rate securities market recovery is delayed. Our actual results may differ materially from the results discussed in the forward-looking statements for a variety of reasons, including those set forth under Risk Factors and in other documents we file from time to time with the Securities and Exchange Commission, including our Annual Report on Form 10-K filed in March 2008, and our periodic Form 10-Q s and Form 8-K s.

Critical Accounting Policies and Estimates

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

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

Estimates and assumptions about future events and their effects cannot be determined with certainty. We base our estimates on historical experience and on various other assumptions believed to be applicable and reasonable under the circumstances. These estimates may change as new events occur, as additional information is obtained and as our operating environment changes. These changes have historically been minor and have been included in our consolidated financial statements as soon as they become known. In addition, management is periodically faced with uncertainties, the outcomes of which are not within its control and will not be known for prolonged periods of time. Many of these uncertainties are discussed in Item 1A of Part II below entitled Risk Factors. Nonetheless, based on a critical assessment of our accounting policies and the underlying judgments and uncertainties affecting the application of these policies, management believes that our consolidated financial statements are fairly stated in accordance with US GAAP, and provide a meaningful presentation of our financial condition and results of operation.

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

Revenue Recognition

Certain of our system sales with customer acceptance provisions are accounted for as multiple-element arrangements. If we have previously met defined customer acceptance levels with the specific type of system, then we recognize revenue for the fair market value of the system upon shipment and transfer of title, and recognize revenue for the fair market value of installation and acceptance services when those services are completed. We

estimate the fair market value of the installation and acceptance services based on our actual historical experience of the relative cost of such installation and acceptance services. For systems that have generally not been demonstrated to meet a particular customer s product specifications prior to shipment, revenue recognition is typically deferred until customer acceptance. For example, while initial shipments of our 200 Lean System were recognized as revenue upon customer acceptance during 2004, revenue was recognized upon shipment for the majority of 200 Leans shipped in 2005, 2006 and 2007. The systems shipped in the first quarter of 2008 and the five Gen I 200 Lean systems in backlog at March 29, 2008 are for a customer for whom we have met defined customer acceptance levels, and we expect to recognize revenue upon shipment. We anticipate that we will recognize revenue on our newly developed systems in 2008, including the two Gen II 200 Lean systems currently in backlog, upon customer acceptance, until such systems meet defined customer acceptance levels.

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

Revenues for systems without installation and acceptance provisions, as well as revenues from technology upgrades, spare parts, consumables and products built by the Imaging Instrumentation business are recognized when title passes to our customer. In certain cases, technology upgrade sales are accounted for as multiple-element arrangements, usually split between delivery of the parts and installation on the customer s systems. In these cases, we recognize revenue for the fair market value of the parts upon shipment and transfer of title, and recognize revenue for the fair market value of installation services when those services are completed.

In certain cases, we sell limited rights to our intellectual property. Revenue from the sale of any intellectual property license will generally be recognized at the inception of the license term.

We perform research and development work under various government-sponsored research contracts. These contracts are a mixture of best efforts cost-plus-fixed-fee (CPFF) and firm fixed-price (FFP). Revenue on CPFF contracts is recognized in accordance with contract terms, typically as costs are incurred. Revenue on FFP contracts is generally recognized on the percentage-of-completion method based on costs incurred in relation to total estimated costs. Provisions for estimated losses on government-sponsored research contracts are recorded in the period in which such losses are determined.

Inventories

Inventories are priced using average actual costs and are stated at the lower of cost or market. The carrying value of inventory is reduced for estimated excess and obsolescence by analyzing historical and anticipated demand. In addition, inventories are evaluated for potential obsolescence due to the effect of known and anticipated engineering changes and new products. If actual demand were to be substantially lower than estimated, additional inventory adjustments would be required, which could have a material adverse effect on our business, financial condition and results of operation. A cost-to-market reserve is established for work-in-progress and finished goods inventories when the value of the inventory plus the estimated cost to complete exceeds the net realizable value of the inventory.

Warranty

We provide for the estimated cost of warranty when revenue is recognized. Our warranty is per contract terms and for our systems the warranty typically ranges between 12 and 24 months from customer acceptance. For systems sold through our distributor, we offer a 3 month warranty. The remainder of any warranty period is the responsibility of the distributor. During this warranty period any defective non-consumable parts are replaced and installed at no charge to the customer. The warranty period on consumable parts is limited to their reasonable usable lives. We use estimated

repair or replacement costs along with our historical warranty experience to determine our warranty obligation. We exercise judgment in determining the underlying estimates. We also provide for estimated retrofit costs, which typically relate to design changes or improvements we identify. On a case-by-case basis, we determine whether or not to retrofit systems in the field at no charge to the customer. Should actual warranty costs differ substantially from our estimates, revisions to the estimated warranty liability would be required, which could have a material adverse effect on our business, financial condition and results of operations.

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Income Taxes

We account for income taxes in accordance with Statement of Financial Accounting Standard No. 109, Accounting for Income Taxes, (SFAS 109), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that a portion of the deferred tax asset will not be realized. As of December 31, 2007, $7.3 million of the deferred tax asset was recorded on the balance sheet, net of a valuation allowance of $2.7 million. This represents the amount of the deferred tax asset from which we expect to realize a benefit. We cannot predict with certainty when, or if, we will realize the benefit of the portion of the deferred tax asset currently offset with a valuation allowance.

On a quarterly basis, we provide for income taxes based upon an annual effective income tax rate. The effective tax rate is highly dependent upon the level of our projected earnings, the geographic composition of worldwide earnings, tax regulations governing each region, net operating loss carry-forwards, availability of tax credits and the effectiveness of our tax planning strategies. We carefully monitor the changes in many factors and adjust our effective income tax rate on a timely basis. If actual results differ from the estimates, this could have a material effect on our business, financial condition and results of operations. For example, as our projected level of earnings changed throughout 2007 and we benefited from various tax planning strategies, we decreased the annual effective tax rate from 31.6% at the end of the first quarter, to 26.9% at the end of the second quarter, to 24.0% at the end of the third quarter and to 23.1% at the end of the fourth quarter.

The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of complex tax laws. Resolution of these uncertainties in a manner inconsistent with our expectations could have a material effect on our business, financial condition and results of operations.

Results of Operations

Three Months Ended March 29, 2008 and March 31, 2007.

Net revenues

	Three Months Ended		**Change over Prior Period**	
	March 29, 2008	**March 31, 2007**	**Amount**	**%**
	(In thousands, except percentages)			
Equipment net revenues	$ 26,973	$ 72,446	$ (45,473)	(63)%
Imaging Instrumentation net revenues	6,202	3,928	2,274	58%
Total net revenues	$ 33,175	$ 76,374	$ (43,199)	(57)%

Net revenues consist primarily of sales of equipment used to manufacture thin-film disks, and, to a lesser extent, related equipment and system components; flat panel equipment technology license fees; contract research and development related to the development of electro-optical sensors, cameras and systems; and low light imaging products.

Equipment revenue for the three months ending March 29, 2008 included revenue recognition for two 200 Lean Systems, ten disk lubrication systems, one Acculuber[tm], which was accepted by the customer, and revenue from disk equipment technology upgrades and spare parts. We shipped our initial Gen II 200 Lean system as a customer evaluation unit. The Gen II system is an upgrade of our Gen I 200 Lean system and features a 25% improvement in throughput, improved uptimes and reduced particle contamination compared to the original 200 lean system. No revenue was recognized on this system during the three months ended March 29, 2008. Equipment revenue for the three months ending March 31, 2007 included revenue recognition for thirteen 200 Lean systems, and revenue from disk equipment technology upgrades and spare parts. We also sold a D-Star® flat panel technology license for $1.3 million during the three months ended March 31, 2007. We expect Equipment revenues in 2008 to be significantly lower than in 2007, due to fewer shipments of 200 Lean systems. The reduction in 200 Lean

shipments in 2008 is due primarily to our customers use of legacy MDP 250B systems that have been sitting idle for at least a year.

Imaging Instrumentation revenue for the three months ending March 29, 2008 consisted of $4.1 million of research and development contract revenue and a record $2.1 million of product sales. Revenue for the three months ending March 31, 2007 consisted of $2.8 million of research and development contract revenue and $1.1 million of product sales. The increase in product revenue resulted from higher sales of digital night vision camera modules and commercial products. Product revenue included contributions from DeltaNu and Creative Display Systems, both of which were acquired in 2007. The increase in contract research and development revenue was the result of a higher volume of contracts and incremental revenue generated from contract close-outs. We expect Imaging Instrumentation revenue to grow significantly, due primarily to increased product sales, which we expect to represent over 50% of our Imaging Instrumentation revenue in 2008. Substantial growth in future Imaging Instrumentation revenues is dependent on proliferation of our technology into major military weapons programs, the ability to obtain export licenses for foreign customers, obtaining production subcontracts for these programs, and development and sale of commercial products.

Our backlog of orders at March 29, 2008 was $43.5 million, as compared to $34.2 million at December 31, 2007 and $92.8 million at March 31, 2007. The $43.5 million of backlog at March 29, 2008 consisted of $35.1 million of Equipment backlog and $8.4 million of Imaging Instrumentation backlog. The $34.2 million of backlog at December 31, 2007 consisted of $28.4 million of Equipment backlog and $5.8 million of Imaging Instrumentation backlog. Backlog at March 29, 2008 includes seven 200 Lean systems, compared to two at December 31, 2007 and fourteen at March 31, 2007.

International sales decreased by 62% to $26.4 million for the three months ended March 29, 2008 from $69.4 million for the three months ended March 31, 2007. International revenues include products shipped to overseas operations of U.S. companies. The decrease in international sales was primarily due to a decrease in net revenues from disk sputtering systems and disk equipment technology upgrades and spare parts. Substantially all of our international sales are to customers in Asia. International sales constituted 80% of net revenues for the three months ended March 29, 2008 and 91% of net revenues for the three months ended March 31, 2007. Our mix of domestic versus international sales will change from period to period depending on the location of our largest customers in each period.

Gross margin

	Three Months Ended		
	March 29,	March 31,	
	2008	2007	% Change
	(In thousands, except percentages)		
Equipment gross profit	$ 12,708	$ 31,345	(59)%
% of Equipment net revenues	47.1%	43.3%	
Imaging instrumentation gross profit	$ 2,603	$ 1,437	81%
% of Imaging net revenues	42.0%	36.6%	
Total gross profit	$ 15,311	$ 32,782	(53)%
% of net revenues	46.2%	42.9%	

Cost of net revenues consists primarily of purchased materials and costs attributable to contract research and development, and also includes fabrication, assembly, test and installation labor and overhead, customer-specific

engineering costs, warranty costs, royalties, provisions for inventory reserves and scrap. Cost of net revenues for the three months ended March 29, 2008 and March 31, 2007 included $249,000 and $173,000 of equity-based compensation expense, respectively.

Equipment gross margin improved to 47.1% in the three months ended March 29, 2008 from 43.3% in the three months ended March 31, 2007. The higher gross margin was due primarily to upgrades and spares being a larger portion of our product mix and the impact of our product cost reduction programs. We expect the gross margin for the Equipment business in 2008 to be somewhat lower than in 2007, primarily as a result of a reduction in volume. Gross margins in the Equipment business will vary depending on a number of additional factors, including product

mix, product cost, system configuration and pricing, factory utilization, and provisions for excess and obsolete inventory.

Imaging Instrumentation gross margin improved to 42.0% in the three months ended March 29, 2008 from 36.6% in the three months ended March 31, 2007. The increase in gross margin resulted primarily from higher margins on development contracts and an increased percentage of revenue derived from higher-margin product shipments, including products shipped by DeltaNu and Creative Display Systems, both of which were acquired in 2007. We expect the gross margin for the Imaging Instrumentation business in 2008 to improve over 2007, primarily as a result of the projected increase in product sales, which typically carry higher gross margins.

Research and development

	Three Months Ended		Change over Prior Period	
	March 29, 2008	March 31, 2007	Amount	%
	(In thousands, except percentages)			
Research and development expense	$ 9,388	$ 12,192	$ (2,804)	(23)%
% of net revenues	28.2%	16.0%		

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, semiconductor equipment and Imaging Instrumentation products. Research and development expense for the three months ended March 29, 2008 and March 31, 2007 included $466,000 and $502,000 of equity-based compensation expense, respectively.

Research and development spending decreased in both Equipment and in Imaging Instrumentation during the three months ended March 29, 2008 as compared to the three months ended March 31, 2007. The decrease in Equipment spending was due primarily to a reduction in charges to development projects for purchased parts and other materials, and, to a lesser extent, a reduction in accruals for bonus and employee profit sharing plans. The decrease in Imaging Instrumentation research and development spending was due primarily to labor being directed to research and development contracts, under which the labor is reflected as cost of net revenues. Engineering headcount decreased from 137 at March 31, 2007 to 129 at March 29, 2008. We expect that research and development spending will decrease slightly in 2008 due primarily to a reduction in expenditures related to the initial development of our Lean Etch™ product line.

Research and development expenses do not include costs of $2,474,000 and $1,507,000 for the three-month periods ended March 29, 2008 and March 31, 2007, respectively, which are related to contract research and development and included in cost of net revenues.

Selling, general and administrative

	Three Months Ended		Change over Prior Period	
	March 29, 2008	March 31, 2007	Amount	%

	(In thousands, except percentages)			
Selling, general and administrative expense	$ 7,064	$ 7,513	$ (449)	(6)%
% of net revenues	21.3%	9.8%		

Selling, general and administrative expense consists primarily of selling, marketing, customer support, financial and management costs and also includes production of customer samples, travel, liability insurance, legal and professional services and bad debt expense. All domestic sales and international sales of disk sputtering products in Asia, with the exception of Japan, are typically made by Intevac s direct sales force, whereas sales in Japan of disk sputtering products and other products are typically made by our Japanese distributor, Matsubo, who provides services such as sales, installation, warranty and customer support. We also have subsidiaries in Singapore and in Hong Kong, along with field offices in Japan, Malaysia, Korea and Shenzhen, China to support our

equipment customers in Asia. Selling, general and administrative expense for the three months ended March 29, 2008 and March 31, 2007 included $881,000 and $679,000, of equity-based compensation expense, respectively.

The decrease in selling, general and administrative spending in the three months ended March 29, 2008 was primarily the result of decreases in costs related to business development, customer service and support in the Equipment business, a reduction in legal expenses associated with the Unaxis litigation and a reduction in accruals for bonus and employee profit sharing plans, partially offset by the added expense associated with the two companies acquired in 2007. Our selling, general and administrative headcount increased from 87 at March 31, 2007 to 111 at March 29, 2008. We expect that selling, general and administrative expenses will increase in 2008 over the amount spent in 2007 due primarily to a projected increase in costs related to customer service and support for the Equipment business and the addition of key business development personnel in the Imaging Instrumentation business. This will be partially offset by lower provisions for employee profit sharing and bonus plans, resulting from our expectations of lower profits in 2008.

Interest income and other, net

	Three Months Ended		Change over Prior Period	
	March 29, 2008	March 31, 2007	Amount	%
	(In thousands, except percentages)			
Interest income and other, net	$ 1,411	$ 1,320	$ 91	7%

Interest income and other, net consists primarily of interest and dividend income on investments and foreign currency gains and losses. The increase in the three months ended March 29, 2008 was driven by a higher average balance of investments, partially offset by foreign currency losses. We expect interest income and other, net to decrease in 2008 due to the sale of our real estate investment in the fourth quarter of 2007 and a reduction in interest income due primarily to a reduction in interest rates.

Provision for income taxes

	Three Months Ended		Change over Prior Period	
	March 29, 2008	March 31, 2007	Amount	%
	(In thousands, except percentages)			
Provision for income taxes	$ (1,293)	$ 4,552	$ (5,845)	N/A

For the three months ended March 29, 2008, we accrued income tax using an effective tax rate of (478.9)% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes. Our tax rate differs from the applicable statutory rates due primarily to the utilization of deferred and current credits, the effect of permanent differences and the geographical composition of our worldwide earnings. Due to the fact that an overall tax benefit is projected for the year based on positive pre-tax earnings, the quarterly effective rate is computed by separately applying an estimated U.S. tax rate to U.S. earnings and an estimated foreign tax to foreign earnings to arrive at an overall effective tax rate

for the quarter in accordance with FASB Interpretation No. 18 Accounting for income Taxes in Interim Periods, an interpretations of APB opinion No. 28. Our deferred tax asset of $11.8 million is partially offset by a valuation allowance, resulting in a net deferred tax asset of $9.1 million at March 29, 2008. The valuation allowance is attributable to state temporary differences and deferred research and development credits that are not realizable in 2008.

For the three months ended March 31, 2007, we accrued income tax using an effective tax rate of 31.6% of pretax income. This rate is based on an estimate of our annual tax rate calculated in accordance with Statement of Financial Accounting Standards No. 109, Accounting for Income Taxes . Our effective tax rate is highly dependent on the availability of tax credits and the geographic composition of our worldwide earnings.

Stock-Based Compensation

During the three months ended March 29, 2008 and March 31, 2007, we recorded stock-based compensation expense related to stock options of $1.3 million and $1.1 million, respectively. As of March 29, 2008, the unrecorded deferred stock-based compensation balance related to stock options was $8.7 million and will be recognized over an estimated weighted average recognition period of 1.49 years.

The compensation cost associated with the employee stock purchase plan for the three months ended March 29, 2008 and March 31, 2007 was $202,000 and $213,000, respectively. There were 79,810 shares purchased under the employee stock purchase plan during the three months ended March 29, 2008.

Approximately $111,000 and $73,000 of stock-based compensation was capitalized as inventory at March 29, 2008 and March 31, 2007, respectively.

Liquidity and Capital Resources

At March 29, 2008, we had $125.0 million in cash, cash equivalents, and investments compared to $140.7 million at December 31, 2007. During the first fiscal quarter of 2008, cash and cash equivalents decreased by $398,000, due primarily to the cash used by operating activities, purchase of fixed assets and a scheduled payment to the owners of DeltaNu, LLC, which was only partially offset by the net sale of investments.

Operating activities used cash of $11.8 million in the first quarter of 2008 and provided cash of $13.2 million in the first quarter of 2007. The decrease in cash provided by operating activities was due primarily to the reduction in net income in the first quarter of 2008, an increase in accounts receivable, and a decrease in accrued payroll during the first quarter of 2008.

Accounts receivable totaled $22.8 million at March 29, 2008, compared to $14.2 million at December 31, 2007. The increase of $8.6 million in the receivable balance was due primarily to the 200 Lean systems recognized for revenue in the first quarter and billings for customer advances related to the Gen II 200 Lean order received in the quarter. Total net inventories were essentially unchanged during the first quarter of 2008. Accounts payable decreased $853,000 to $6.8 million at March 29, 2008. Accrued payroll and related liabilities decreased by $5.1 million during the three months ended March 29, 2008 due primarily to bonuses and profit sharing payments. Other accrued liabilities declined by $382,000 to $5.4 million. Customer advances decreased by $430,000 during the first quarter of 2008, as liquidations related to revenue recognition were slightly higher than new advances billed to our customers.

Investing activities in the first three months of 2008 provided cash of $10.6 million. Proceeds from the sale and maturities of investments, net of new purchases, totaled $13.9 million. Capital expenditures for the three months ended March 29, 2008 were $1.3 million.

Financing activities provided cash of $804,000 during the three months ended March 29, 2008 due to the sale of Intevac common stock to our employees through our employee benefit plans. We made a scheduled payment of $2.0 million to the owners of DeltaNu, LLC, which we acquired in the first quarter of 2007.

We have generated operating income for the last three fiscal years, after incurring annual operating losses from 1998 through 2004. We currently expect to incur a slight operating loss in 2008, due to the reduction in Equipment revenue as compared to 2007.

As of March 29, 2008, we had $78.4 million par value invested in auction rate securities (ARS). During the three months ended March 29, 2008, we recorded an unrealized loss of $1.6 million due to the failure of the auctions

associated with these securities. We have determined this reduction in fair value to be temporary. Refer to Note 9 of Notes to Condensed Consolidated Financial Statements and Item 1A Risk Factors for further details regarding our investments in ARS.

We have entered into a line of credit with Citigroup Global Markets Inc. under which approximately $20 million is available to us. We intend to use this line to help secure our ability to fund our cash requirements until we are able to liquidate our ARS holdings.

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We believe that our existing cash, cash equivalents, short-term investments and credit facility will be sufficient to meet our cash requirements for the foreseeable future. We intend to undertake approximately $6 to $7 million in capital expenditures during the remainder of 2008.

Contractual Obligations

In the normal course of business, we enter into various contractual obligations that will be settled in cash. These obligations consist primarily of operating leases and purchase orders placed in the normal course of business. The expected future cash flows required to meet these obligations as of March 29, 2008 are shown in the table below.

	Payments Due by Period				
	Total	< 1 Year	1-3 Years	3-5 Years	> 5 Years
			(In thousands)		
Operating lease obligations	$ 10,393	$ 2,553	$ 5,044	$ 2,737	$ 59
Purchase obligations	17,086	17,086			
Total	$ 27,479	$ 19,639	$ 5,044	$ 2,737	$ 59

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

Interest rate risk. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio. We do not use derivative financial instruments in our investment portfolio. We place our investments with high quality credit issuers and, by policy, limit the amount of credit exposure to any one issuer. Investments typically consist of investments in A1/P1 rated commercial paper, auction rate securities and debt instruments issued by the U.S. government and its agencies.

The table below presents principal amounts and related weighted-average interest rates by year of maturity for our investment portfolio at March 29, 2008.

	2008	2009	2010	Beyond	Total	Fair Value
		(In thousands, except percentages)				
Cash equivalents						
Fixed rate amounts	$ 5,991				$ 5,991	$ 5,995
Weighted-average rate	3.32%					
Variable rate amounts	$ 8,569				$ 8,569	$ 8,569
Weighted-average rate	1.30%					
Short-term investments						
Fixed rate amounts	$ 18,888				$ 18,888	$ 19,005
Weighted-average rate	4.25%					
Long-term investments						
Fixed rate amounts		$ 2,005			$ 2,005	$ 2,014
Weighted-average rate		4.43%				

Variable rate amounts			$ 76,783	$ 76,783	$ 76,783
Weighted-average rate			3.78%		
Total investment portfolio	$ 33,448	$ 2,005	$ 76,783	$ 112,236	$ 112,366

Due to the short-term nature of the substantial portion of our investments, we believe that we do not have any material exposure to changes in the fair value of our investment portfolio as a result of changes in interest rates. In the first quarter of 2008, our Auction Rate Securities have experienced multiple failed auctions. Based on our valuation model and an analysis of other-than-temporary impairment factors, we wrote down our ARS investments to an estimated fair value of $76.8 million at March 29, 2008. This write-down resulted in a temporary impairment charge of $1.6 million, which is reflected as unrealized loss within other comprehensive income. We review impairments associated with the above in accordance with Emerging Issues Task Force (EITF) 03-01 and

FSP SFAS 115-1 and 124-1, The Meaning of Other-Than-Temporary-Impairment and Its Application to Certain Investments, to determine the classification of the impairment as temporary or other-than-temporary. A temporary impairment charge results in an unrealized loss being recorded in the other comprehensive income component of stockholders equity. Such as unrealized loss does not reduce net income for the applicable accounting period because the loss is not viewed as other-than-temporary.

Foreign exchange risk. From time to time, we enter into foreign currency forward exchange contracts to economically hedge certain of our anticipated foreign currency transaction, translation and re-measurement exposures. The objective of these contracts is to minimize the impact of foreign currency exchange rate movements on our operating results. At March 29, 2008, we had no foreign currency forward exchange contracts.

Item 4. *Controls and Procedures*

Evaluation of disclosure controls and procedures.

We maintain a set of disclosure controls and procedures that are designed to ensure that information relating to Intevac, Inc. required to be disclosed in periodic filings under Securities Exchange Act of 1934, or Exchange Act, is recorded, processed, summarized and reported in a timely manner under the Exchange Act. In connection with the filing of this Form 10-Q for the quarter ended March 29, 2008, as required under Rule 13a-15(b) of the Exchange Act, an evaluation was carried out under the supervision and with the participation of management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of March 29, 2008.

Attached as exhibits to this Quarterly Report are certifications of the CEO and the CFO, which are required in accordance with Rule 13a-14 of the Securities Exchange Act of 1934, as amended (Exchange Act). This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications, and it should be read in conjunction with the certifications for a more complete understanding of the topics presented.

Definition of Disclosure Controls

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

Limitations on the Effectiveness of Controls

Our management, including the CEO and CFO, does not expect that our Disclosure Controls or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of

controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential

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future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Changes in internal controls over financial reporting

There were no changes in our internal controls over financial reporting that occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

Patent Infringement Complaint against Unaxis

On July 7, 2006, we filed a patent infringement lawsuit against Unaxis USA, Inc. (a wholly owned subsidiary of Oerlikon) and its affiliates, Unaxis Balzers AG and Unaxis Balzers, Ltd., in the United States District Court for the Central District of California. Our lawsuit against Unaxis asserts infringement by Unaxis of United States Patent 6,919,001, which relates to our 200 Lean system. Our complaint seeks monetary damages and an injunction that bars Unaxis from making, using, offering to sell or selling in the United States, or importing into the United States, Unaxis allegedly infringing product. In the suit, we seek damages and a permanent injunction for infringement of the same patent. We believe we have meritorious claims, and we intend to pursue them vigorously.

On September 12, 2006, Unaxis filed a response to our lawsuit in which it asserted non-infringement, invalidity of our patent, inequitable conduct by Intevac, patent misuse by Intevac, and lack of jurisdiction by the court as defenses. Additionally, Unaxis requested a declaratory judgment of patent non-infringement, invalidity and unenforceability; asserted our violation of the California Business and Professional Code; requested that we be enjoined from engaging in any unfair competition; and requested that we be required to pay Unaxis attorney fees. We believe such claims lack merit, and we intend to defend ourselves vigorously.

We replied to Unaxis response on October 3, 2006, denying the assertions of non-infringement, invalidity and unenforceability of the Intevac patent, and denying any unfair competition. With the approval of the Court, we amended our complaint on February 6, 2007 to assert an additional ground for our infringement claim and to add a request for a declaratory judgment of infringement. Unaxis filed a response on February 21, 2007, in which it repeated the assertions of its September 12, 2006 response.

On May 21, 2007, the Court granted Unaxis request to stay the litigation pending reexamination of our United States Patent 6,919,001, after the U.S. Patent Office granted Unaxis February 27, 2007 reexamination request and issued an initial office action rejecting the claims of the patent. The Court also ordered the parties to file a joint report every 120 days to keep it appraised of the reexamination status. Intevac had no input to the initial office action determination by the U.S. Patent Office.

On June 20, 2007, we filed a reply to the initial office action reexamination. Our reply addresses the office action s rejections of the patent s original claims and proposes amended claims that we believe are supported by the original patent s specification. Unaxis responded to our reply, and the U.S. Patent Office is now considering both parties submissions. During the reexamination process, the patent remains valid.

Other Legal Matters

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

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Item 1A. *Risk Factors*

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

Our Equipment business sells equipment to capital-intensive industries, which sell commodity products such as disk drives and semiconductors. When demand for these commodity products exceeds capacity, demand for new capital equipment such as ours tends to be amplified. Conversely, when supply of these commodity products exceeds demand, the demand for new capital equipment such as ours tends to be depressed. For example, the hard disk drive industry has been historically subject to multi-year cycles because of the long lead times and high costs involved in adding capacity, and to seasonal cycles driven by consumer purchasing patterns, which tend to be heaviest in the third and fourth quarters of each year.

The cyclical nature of the capital equipment industry means that in some years we will have unusually high sales of new systems, and that in other years our sales of new systems will be severely depressed. The timing, length and volatility of these cycles are difficult to predict. These cycles have affected the timing and amounts of our customers capital equipment purchases and investments in new technology. For example, sales of systems for magnetic disk production were severely depressed from mid-1998 until mid-2003 and grew rapidly from 2004 through 2006. The number of new systems delivered or scheduled for delivery in the second half of 2007 was significantly lower than the number of systems delivered in the first half of the year, and we are projecting that new system shipments will be significantly lower in 2008 than 2007. We cannot predict with any certainty when these cycles will begin or end.

If demand for hard disk drives does not continue to grow and our customers do not replace or upgrade their installed base of disk sputtering systems, then future sales of our disk sputtering systems will suffer.

From mid-1998 until mid-2003, there was very little demand for new disk sputtering systems, as magnetic disk manufacturers were burdened with over-capacity and were not investing in new disk sputtering equipment. By 2003, however, over-capacity had diminished, and orders for our 200 Lean began to increase. From 2004 through the end of 2006, there was strong demand for new disk sputtering systems.

Sales of our equipment for capacity expansions are dependent on the capacity expansion plans of our customers and upon whether our customers select our equipment for their capacity expansions. We have no control over our customers expansion plans, and we cannot be sure that they will select our equipment if they do expand their capacity. Our customers may not implement capacity expansion plans, or we may fail to win orders for equipment for those capacity expansions, which could have a material adverse effect on our business and our operating results. In addition, some manufacturers may choose to purchase used systems from other manufacturers or customers rather than purchasing new systems from us.

Sales of our 200 Lean disk sputtering systems are also dependent on obsolescence and replacement of the installed base of disk sputtering equipment. If technological advancements are developed that extend the useful life of the installed base of systems, then sales of our 200 Lean will be limited to the capacity expansion needs of our customers, which would significantly decrease our revenue. For example, during 2007 some of our customers decided to use legacy systems for the production of first generation perpendicular media, which delayed the replacement of such legacy systems with new 200 Lean systems.

Our customers have experienced competition from companies that produce alternative storage technologies like flash memory, where increased capacity, improving cost, lower power consumption and performance ruggedness have resulted in competition with lower capacity, smaller form factor disk drives in handheld applications. While this competition has traditionally been in the markets for handheld consumer electronics applications like personal media

players, these competitors have recently announced products for notebook and enterprise computer applications. If alternative technologies, such as flash memory, replace hard disk drives as a primary method of digital storage, then demand for our products would likely decrease.

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We are exposed to risks associated with a highly concentrated customer base.

Historically, a significant portion of our revenue in any particular period has been attributable to sales of our disk sputtering systems to a limited number of customers. In 2007, one of our customers accounted for 31% of our revenues, and four customers in the aggregate accounted for 90% of our revenues. The same four customers, in the aggregate, accounted for 31% of our net accounts receivable at December 31, 2007. During 2006, Seagate acquired Maxtor, and during 2007 Western Digital acquired Komag. This consolidation in the industry limits the number of potential customers for our products. Orders from a relatively limited number of magnetic disk manufacturers have accounted for, and likely will continue to account for, a substantial portion of our revenues. The loss of, or delays in purchasing by, any one of our large customers would significantly reduce potential future revenues. In addition, the concentration of our customer base may enable customers to demand pricing and other terms unfavorable to us, and makes us more vulnerable to any changes in demand by a given customer. Furthermore, the concentration of customers can lead to extreme variability in revenue and financial results from period to period. For example, during 2007 revenues ranged between $76.4 million in the first quarter and $16.8 million in the fourth quarter.

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

Over the last nine quarters, our revenues per quarter have fluctuated between $16.8 million and $95.9 million. Over the same period our operating income (loss) as a percentage of revenues has fluctuated between approximately 23% and (42%) of revenues. We anticipate that our revenues and operating margins will continue to fluctuate. We expect this fluctuation to continue for a variety of reasons, including:

changes in the demand, due to seasonality, cyclicality and other factors in the markets, for computer systems, storage subsystems and consumer electronics containing disks our customers produce with our systems;

delays or problems in the introduction and acceptance of our new products, or delivery of existing products;

timing of orders, acceptance of new systems by our customers or cancellation of those orders; and

new products, services or technological innovations by our competitors or us.

Additionally, because our systems are priced in the millions of dollars and we sell a relatively small number of systems, we believe that quarter-to-quarter comparisons of our revenues and operating results may not be an accurate indicator of our future performance. Our operating results in one or more future quarters may fail to meet the expectations of investment research analysts or investors, which could cause an immediate and significant decline in the trading price of our common shares.

Our long-term revenue growth is dependent on new products. If these new products are not successful, then our results of operations will be adversely affected.

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

The majority of our revenues in both fiscal 2007 and fiscal 2006 were from sales of our 200 Lean disk sputtering system and related parts and services. The 200 Lean was first delivered in December 2003. When first introduced, advanced vacuum manufacturing equipment, such as the 200 Lean, is subject to extensive customer acceptance tests after installation at the customer s factory. These acceptance tests are designed to validate reliable operation to specifications in areas such as throughput, vacuum level, robotics, process performance and software features and functionality. These tests are generally more comprehensive for new systems than for mature systems, and are designed to highlight problems encountered with early versions of the equipment. For example, initial builds of the 200 Lean experienced high production and warranty costs in comparison to our more established product lines. Failure to promptly address any of the problems uncovered in these tests could have adverse effects on

our business, including rescheduling of backlog, failure to achieve customer acceptance and therefore revenue recognition as anticipated, unanticipated product rework and warranty costs, penalties for non-performance, cancellation of orders, or return of products for credit.

We are making a substantial investment to develop our new Lean Etch system for semiconductor manufacturing. We spent a substantial portion of our research and development costs on this new product in 2006 and increased our level of spending on this project in 2007. We may experience problems with the Lean Etch similar to the startup problems encountered with the 200 Lean. Moreover, we have not developed or sold products for this market previously. Failure to correctly assess the size of the market, to successfully develop a cost effective product to address the market, or to establish effective sales and support of the new product would have a material adverse effect on our future revenues and profits, and could include loss of our entire investment in the project.

We are jointly developing a next generation head mounted night-vision system with another defense contractor. This system is planned for sale to the U.S. military and will compete with head-mounted systems developed by our competitors. The U.S. military does not intend to initiate production of this system until 2011. We plan to make a significant investment in this type of product and cannot be assured when, or if, we will be awarded any production contracts for these night vision systems.

We have developed a night-vision sensor and camera module for use in a NATO customer s digital rifle-sight system. We cannot guarantee that we will achieve the yield improvements and cost reductions necessary for this program to be successful. Shipments under this program are subject to export approval by the U.S. government.

Products based on our LIVAR target identification and low light level camera technologies are designed to offer significantly improved capability to military customers. We are also developing commercial products in our Imaging Instrumentation business. None of our Imaging Instrumentation products are currently being manufactured in high volume, and we may encounter unforeseen difficulties when we commence volume production of these products. Our Imaging Instrumentation business will require substantial further investment in sales and marketing, in product development and in additional production facilities in order to expand our operations. We may not succeed in these activities or generate significant sales of these new products. In 2007, sales of our Imaging Instrumentation products were $5.2 million out of a total of $19.1 million of Imaging Instrumentation revenues.

Failure of any of these new products to perform as intended, to penetrate their markets and develop into profitable product lines or to achieve their production cost objectives would have a material adverse effect on our business.

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

The sales cycle for our Equipment systems can be a year or longer, involving individuals from many different areas of our company and numerous product presentations and demonstrations for our prospective customers. Our sales process for these systems also commonly includes production of samples, customization of our product and installation of evaluation systems in the factories of our prospective customers. We do not enter into long-term contracts with our customers, and therefore until an order is actually submitted by a customer there is no binding commitment to purchase our systems.

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

As a result, we may not recognize revenue from our products for extended periods of time after we have completed development and made initial shipments of our products, during which time we may expend substantial funds and management time and effort with no assurance that a sale will result.

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

In the market for our disk sputtering systems, we have experienced competition from competitors such as Anelva Corporation, which is a subsidiary of Canon, and Oerlikon, each of which has sold substantial numbers of systems worldwide. In the market for semiconductor equipment, we expect to experience competition from competitors such as Applied Materials, LAM Research and Tokyo Electron, Ltd. In the market for our military Imaging Instrumentation products, we experience competition from companies such as ITT Industries, Inc., Northrop Grumman Corporation and BAE. In the markets for our commercial Imaging Instrumentation products, we compete with companies such as Andor, E2V, Hamamatsu, Texas Instruments and Roper Scientific for sensor and camera products, and with companies such as Ahura, B&W Tek, Horiba Jobin Yvon, InPhotonics, Ocean Optics, Renishaw, and Smiths Detection for portable Raman spectrometer products. Our competitors have substantially greater financial, technical, marketing, manufacturing and other resources than we do, especially in the semiconductor equipment market where we have not previously offered a product. We cannot assure you that our competitors will not develop enhancements to, or future generations of, competitive products that offer superior price or performance features. Likewise, we cannot assure you that new competitors will not enter our markets and develop such enhanced products. Moreover, competition for our customers is intense, and our competitors have historically offered substantial pricing concessions and incentives to attract our customers or retain their existing customers.

We may not be successful in maintaining and obtaining the necessary export licenses to conduct operations abroad, and the United States government may prevent proposed sales to foreign customers.

Many of our Imaging Instrumentation products require export licenses from United States Government agencies under the Export Administration Act, the Trading with the Enemy Act of 1917, the Arms Export Act of 1976 and the International Traffic in Arms Regulations. This limits the potential market for our products. We can give no assurance that we will be successful in obtaining all the licenses necessary to export our products. Recently, heightened government scrutiny of export licenses for products in our market has resulted in lengthened review periods for our license applications. Export to countries which are not considered by the United States Government to be allies is likely to be prohibited, and even sales to U.S. allies may be limited. Failure to obtain, delays in obtaining, or revocation of previously issued licenses would prevent us from selling our products outside the United States, may subject us to fines or other penalties, and would have a material adverse effect on our business, financial condition and results of operations.

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

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

unable to pass on to the customer and that may affect our gross margins. Sometimes we work closely with our customers to develop new features and products. In connection with these transactions, we sometimes offer a period of exclusivity to these customers.

Our Imaging Instrumentation business depends heavily on government contracts, which are subject to immediate termination and are funded in increments. The termination of or failure to fund one or more of these contracts could have a negative impact on our operations.

We sell many of our Imaging Instrumentation products and services directly to the U.S. government, as well as to prime contractors for various U.S. government programs. Our revenues from government contracts totaled $14.1 million, $10.2 million, and $6.9 million in 2007, 2006, and 2005, respectively. Generally, government contracts are subject to oversight audits by government representatives and contain provisions permitting termination, in whole or in part, without prior notice at the government s convenience upon the payment of compensation only for work done and commitments made at the time of termination. We cannot assure you that one or more of the government contracts under which our customers or we operate will not be terminated under these circumstances. Also, we cannot assure you that we or our customers would be able to procure new government contracts to offset the revenues lost as a result of any termination of existing contracts, nor can we assure you that we or our customers will continue to remain in good standing as federal contractors.

Furthermore, the funding of multi-year government programs is subject to congressional appropriations, and there is no guarantee that the U.S. government will make further appropriations. The loss of funding for a government program would result in a loss of future revenues attributable to that program.

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

Unexpected increases in the cost to develop or manufacture our products under fixed-price contracts may cause us to experience un-reimbursed cost overruns.

A portion of our revenue is derived from fixed-price development and production contracts. Under fixed-price contracts, unexpected increases in the cost to develop or manufacture a product, whether due to inaccurate estimates in the bidding process, unanticipated increases in material costs, reduced production volumes, inefficiencies or other factors, are borne by us. We have experienced cost overruns in the past that have resulted in losses on certain contracts, and may experience additional cost overruns in the future. We are required to recognize the total estimated impact of cost overruns in the period in which they are first identified. Such cost overruns could have a material adverse effect on our results of operation and financial condition.

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

Our customers must make extremely large capital expenditures in order to purchase our systems and other related equipment and facilities. These costs are far in excess of the cost of our systems alone. The magnitude of such capital expenditures requires that our customers have access to large amounts of capital and that they be willing to invest that capital over long periods of time to be able to purchase our equipment. The magnetic disk and semiconductor manufacturing industries have made significant additions to their production capacity in the last few years. Our customers may not be willing or able to continue this level of capital investment, especially during a downturn in the overall economy, the hard disk drive industry, or the semiconductor industry.

Our stock price is volatile.

The market price and trading volume of our common stock has been subject to significant volatility, and this trend may continue. Over the last 12 months, the closing price of our common stock, as traded on The Nasdaq National Market, fluctuated from a low of $10.14 per share to a high of $26.77 per share. The value of our common stock may decline regardless of our operating performance or prospects. Factors affecting our market price include:

- our perceived prospects;
- hard disk drive market expectations;

variations in our operating results and whether we achieve our key business targets;

sales or purchases of large blocks of our stock;

changes in, or our failure to meet, our revenue and earnings estimates;

changes in securities analysts buy or sell recommendations;

differences between our reported results and those expected by investors and securities analysts;

announcements of new contracts, products or technological innovations by us or our competitors;

market reaction to any acquisitions, joint ventures or strategic investments announced by us or our competitors;

our high fixed operating expenses, including research and development expenses;

developments in the financial markets; and

general economic, political or stock market conditions in the United States and other major regions in which we do business.

In addition, the general economic, political, stock market and industry conditions that may affect the market price of our common stock are beyond our control. The market price of our common stock at any particular time may not remain the market price in the future. In the past, securities class action litigation has been instituted against companies following periods of volatility in the market price of their securities. Any such litigation, if instituted against us, could result in substantial costs and a diversion of management s attention and resources.

The liquidity of our Auction Rate Securities is currently impaired, which may impact our ability to meet our cash requirements and require additional debt funding.

At March 29, 2008, we held $78.4 million of Auction Rate Securities (ARS). The market for these securities has historically been highly liquid, even though our ARS have underlying maturities ranging from 23 to 40 years. The liquidity was achieved through auctions, which occurred every 7 or 28 days, depending on the terms of the individual security, in which the interest paid on each security was reset to current market rates.. We did not previously intend to hold these securities to maturity, but rather to use the auction feature to sell the securities as needed to provide liquidity. Beginning in mid-February of 2008, our ARS began incurring failed auctions due to sell orders exceeding buy orders, primarily driven by the decision of the investment banks to not continue participating in the auctions. As of March 29, 2008, all of our holdings have experienced at least two failed auctions. The funds associated with failed auctions will not be accessible until a successful auction occurs, they are restructured into a more liquid security, a buyer is found outside of the auction process, or the underlying securities have matured. We do not know when, or if, one of these circumstances will occur. All of our ARS are student loan structured issues, where the loans have been originated under the Department of Education s Federal Family Education Loan Program and the principal and interest is 97-98% reinsured by the U.S. Department of Education. At this time, there has been no change in the AAA ratings of these securities, but there is no assurance that the AAA ratings will be maintained in the future.

At March 29, 2008, we analyzed the fair value of our ARS using the guidance of Statement of Financial Accounting Standards No. 157, *Fair Value Measurements.* Based on our analysis, we concluded that our ARS holdings had a valuation equal to 98% of par value. We further concluded that the fair value impairment was temporary and recorded

an unrealized loss equal to 2% of par value or $1.6 million. Since we could not be certain that the liquidity issues would be resolved within twelve months, we reclassified all of these securities from short-term to long-term investments. Refer to Note 9 of Notes to Condensed Consolidated Financial Statements for further details regarding our investments in ARS. If the issuer of the ARS is unable to successfully close future auctions; or does not redeem the ARS; or the United States government fails to support its guaranty of the obligations; or the United States Department of Education fails to support its guarantee of the obligations; or these

or any other valuation metrics or processes change, then we may be required to further adjust the carrying value of our ARS and/or record an other-than-temporary impairment charge.

At March 29, 2008 after reclassifying our ARS from short-term to long-term investments, we held $46.2 million of cash and short-term investments. In order to increase our liquidity we entered into a line of credit with Citigroup Global Markets Inc., under which approximately $20 million is available to us, secured by $57.9 million of our ARS. If we are unable to maintain the line of credit, or if the interest rate of the line of credit is prohibitive or the amount of the line of credit is insufficient, we could experience difficulties in meeting our cash requirements until the market for the Auction Rate Securities becomes liquid again and we may have to seek additional debt funding to finance our operations.

Failure to liquidate our portfolio of auction rate securities or otherwise convert them into liquid assets could have a material and adverse effect on our business, financial condition and results of operations.

Changes in tax rates or tax liabilities could affect future results.

As a global company, we are subject to taxation in the United States and various other countries. Significant judgment is required to determine and estimate worldwide tax liabilities. Our future tax rates could be affected by changes in the applicable tax laws, composition of earnings in countries with differing tax rates, changes in the valuation of our deferred tax assets and liabilities, or changes in the tax laws. Although we believe our tax estimates are reasonable, there can be no assurance that any final determination will not be materially different from the treatment reflected in our historical income tax provisions and accruals, which could materially and adversely affect our results of operations.

Our effective tax rate in 2007 was well below the applicable statutory rates due primarily to permanent differences and the utilization of research and development credits. In 2006, our effective tax rate was well below the applicable statutory rates due primarily to the utilization of net operating loss carry-forwards and deferred credits.

We have experienced significant growth and contraction in our business and operations and if we do not appropriately manage this growth and contraction, now and in the future, then our operating results will be negatively affected.

Our business has both grown and contracted significantly in recent years, in both operations and headcount, and this growth and contraction causes significant strain on our infrastructure, internal systems and managerial resources. To manage our growth and contraction effectively, we must continue to improve and enhance our infrastructure, including information technology and financial operating and administrative systems and controls, and continue managing headcount, capital and processes in an efficient manner. Our productivity and the quality of our products may be adversely affected if we do not integrate and train our new employees quickly and effectively and coordinate among our executive, engineering, finance, marketing, sales, operations and customer support organizations, all of which add to the complexity of our organization and increase our operating expenses. We also may be less able to predict and effectively control our operating expenses due to the growth and increasing complexity of our business. In addition, our information technology systems may not grow at a sufficient rate to keep up with the processing and information demands placed on them by a much larger company. The efforts to continue to expand our information technology systems or our inability to do so could harm our business. Further, revenues may not grow at a sufficient rate to absorb the costs associated with a larger overall headcount.

Our future growth may require significant additional resources, given that, as we increase our business operations in complexity and scale, we may have insufficient management capabilities and internal bandwidth to manage our growth and business effectively. We cannot assure you that resources will be available when we need them or that we

will have sufficient capital to fund these potential resource needs. If we are unable to manage our growth effectively or if we experience a shortfall in resources, our results of operations will be harmed.

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

In 2007, approximately 82% of our revenues came from regions outside the United States. Substantially all of our international sales are to customers in Asia, which includes products shipped to overseas operations of

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U.S. companies. We currently have international customer support offices in Singapore, China, Malaysia, Korea and Japan. We expect that international sales will continue to account for a significant portion of our total revenue in future years. Certain of our manufacturing facilities and suppliers are also located outside the United States. Managing our global operations presents challenges including, but not limited to, those arising from:

- varying regional and geopolitical business conditions and demands;
- global trade issues;
- variations in protection of intellectual property and other legal rights in different countries;
- rising raw material and energy costs;
- variations in the ability to develop relationships with suppliers and other local businesses;
- changes in laws and regulations of the United States (including export restrictions) and other countries, as well as their interpretation and application;
- fluctuations in interest rates and currency exchange rates, particularly with the recent decline in the value of the U.S. dollar;
- the need to provide sufficient levels of technical support in different locations;
- political instability, natural disasters (such as earthquakes, hurricanes or floods), pandemics, terrorism or acts of war where we have operations, suppliers or sales;
- cultural differences; and
- shipping delays.

Changes in existing financial accounting standards or practices or taxation rules or practices may adversely affect our results of operations.

Changes in existing accounting or taxation rules or practices, new accounting pronouncements or taxation rules, or varying interpretations of current accounting pronouncements or taxation practice could have a significant adverse effect on our results of operations or the manner in which we conduct our business. Further, such changes could potentially affect our reporting of transactions completed before such changes are effective.

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

Pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, our management must perform evaluations of our internal control over financial reporting. Beginning in 2004, our Form 10-K has included a report by management of their assessment of the adequacy of such internal control. Additionally, our independent registered public accounting firm must publicly attest to the effectiveness of our internal control.

We have completed the evaluation of our internal controls over financial reporting as required by Section 404 of the Sarbanes-Oxley Act. Although our assessment, testing, and evaluation resulted in our conclusion that as of

December 31, 2007, our internal controls over financial reporting were effective, we cannot predict the outcome of our testing in future periods. If our internal controls are ineffective in future periods, our financial results or the market price of our shares could be adversely affected. We will incur additional expenses and commitment of management s time in connection with further evaluations.

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

We are a manufacturing business. Purchased parts constitute the largest component of our product cost. Our ability to manufacture depends on the timely delivery of parts, components and subassemblies from suppliers. We obtain some of the key components and sub-assemblies used in our products from a single supplier or a limited

group of suppliers. If any of our suppliers fail to deliver quality parts on a timely basis, we may experience delays in manufacturing, which could result in delayed product deliveries or increased costs to expedite deliveries or develop alternative suppliers. Development of alternative suppliers could require redesign of our products.

Our business depends on the integrity of our intellectual property rights and failure to protect our intellectual property rights adequately could have a material adverse effect on our business.

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

- any of our pending or future patent applications will be allowed or that any of the allowed applications will be issued as patents or will issue with claims of the scope we sought;
- any of our patents will not be invalidated, deemed unenforceable, circumvented or challenged;
- the rights granted under our patents will provide competitive advantages to us;
- other parties will not develop similar products, duplicate our products or design around our patents; or
- our patent rights, intellectual property laws or our agreements will adequately protect our intellectual property or competitive position.

We may be subject to claims of intellectual property infringement.

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

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

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

The majority of our U.S. operations are located in Santa Clara, California and Fremont, California, where the cost of living and of recruiting employees is high. Additionally, our operating results depend, in large part, upon our ability to retain and attract qualified management, engineering, marketing, manufacturing, customer support, sales and administrative personnel. Furthermore, we compete with similar industries, such as the semiconductor industry, for the same pool of skilled employees. If we are unable to retain key personnel, or if we are not able to attract, assimilate or retain additional highly qualified employees to meet our needs in the future, our business and operations could be harmed.

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

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

We currently quote and sell the majority of our products in U.S. dollars. From time to time, we may enter into foreign currency contracts in an effort to reduce the overall risk of currency fluctuations to our business. However, there can be no assurance that the offer and sale of products denominated in foreign currencies, and the related foreign currency hedging activities, will not adversely affect our business.

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

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

We have completed a number of acquisitions during our operating history. In early 2007, we completed the acquisition of certain assets of DeltaNu, LLC, and in the fourth quarter of 2007 we completed the acquisition of certain assets of Creative Display Systems, LLC. We have spent and will continue to spend significant resources identifying and acquiring businesses. The efficient and effective integration of our acquired businesses into our organization is critical to our growth. Any future acquisitions involve numerous risks including difficulties in integrating the operations, technologies and products of the acquired companies, the diversion of our management s attention from other business concerns and the potential loss of key employees of the acquired companies. Failure to achieve the anticipated benefits of these and any future acquisitions or to successfully integrate the operations of the companies we acquire could also harm our business, results of operations and cash flows. Any future acquisitions may also result in potentially dilutive issuance of equity securities, acquisition- or divestiture-related write-offs or the assumption of debt and contingent liabilities.

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

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

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

Substantially all of our common stock may be sold without restriction in the public markets, although shares held by our directors, executive officers and affiliates may be subject to volume and manner of sale restrictions. Sales of a substantial number of shares of common stock in the public market by our officers, directors or affiliates or the perception that these sales could occur could materially and adversely affect our stock price and make it more difficult for us to sell equity securities in the future at a time and price we deem appropriate.

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

Our certificate of incorporation authorizes our board of directors to issue up to 10,000,000 shares of preferred stock and to determine the powers, preferences, privileges, rights, including voting rights, qualifications, limitations and restrictions of those shares, without any further vote or action by the stockholders. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that we may issue in the future. The issuance of preferred stock could have the effect of delaying, deterring or preventing a change in control and could adversely affect the voting power of your shares. In addition, provisions of Delaware law and

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our bylaws could make it more difficult for a third party to acquire a majority of our outstanding voting stock by discouraging a hostile bid, or delaying or deterring a merger, acquisition or tender offer in which our stockholders could receive a premium for their shares or a proxy contest for control of our company or other changes in our management.

We could be involved in litigation.

From time to time we may be involved in litigation of various types, including litigation alleging infringement of intellectual property rights and other claims. For example, in July 2006, we filed a patent infringement lawsuit against Unaxis USA, Inc. and its affiliates Unaxis Balzers AG and Unaxis Balzers, Ltd. alleging infringement by Unaxis of a patent relating to our 200 Lean system. See Part II, Item 1 of this Form 10-Q for further information regarding this lawsuit. Litigation is expensive and can require significant management time and attention and could have a negative effect on our results of operations or business if we lose or have to settle a case on significantly adverse terms.

Business interruptions could adversely affect our operations.

Our operations are vulnerable to interruption by fire, earthquake or other natural disaster, quarantines or other disruptions associated with infectious diseases, national catastrophe, terrorist activities, war, disruptions in our computing and communications infrastructure due to power loss, telecommunications failure, human error, physical or electronic security breaches and computer viruses, and other events beyond our control. We do not have a fully implemented detailed disaster recovery plan. Despite our implementation of network security measures, our tools and servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems and tools located at customer sites. Political instability could cause us to incur increased costs in transportation, make such transportation unreliable, increase our insurance costs and cause international currency markets to fluctuate. This same instability could have the same effects on our suppliers and their ability to timely deliver their products. In addition, we do not carry sufficient business interruption insurance to compensate us for all losses that may occur, and any losses or damages incurred by us could have a material adverse effect on our business and results of operations. For example, we self-insure earthquake risks, because we believe this is the prudent financial decision based on the high cost of the limited coverage available in the earthquake insurance market. An earthquake could significantly disrupt our operations, most of which are conducted in California. It could also significantly delay our research and engineering effort on new products, most of which is also conducted in California. We take steps to minimize the damage that would be caused by an earthquake, but there is no certainty that our efforts will prove successful in the event of an earthquake.

Item 1B. ***Unresolved Staff Comments***

None.

Item 2. ***Unregistered Sales of Equity Securities and Use of Proceeds***

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.

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Item 6. ***Exhibits***

The following exhibits are filed herewith:

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

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SIGNATURES

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

INTEVAC, INC.

By: /s/ KEVIN FAIRBAIRN

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

Date: May 8, 2008

By: /s/ JEFFREY ANDRESON

Jeffrey Andreson
Vice President, Finance and Administration,
Chief Financial Officer, Treasurer and Secretary (Principal Financial and Accounting Officer)

Date: May 8, 2008

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