INTEVAC INC
Form 10-Q
August 01, 2017
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(MARK ONE)

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

For the quarterly period ended July 1, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from to

Commission file number 0-26946

INTEVAC, INC.

(Exact name of registrant as specified in its charter)

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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes No

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

On August 1, 2017, 21,782,377 shares of the Registrant s Common Stock, $0.001 par value, were outstanding.

Table of Contents

INTEVAC, INC.

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. ***Financial Statements***

INTEVAC, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

	July 1, 2017	December 31, 2016
	(Unaudited)	
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 19,575	$ 27,043
Short-term investments	14,217	17,602
Trade and other accounts receivable, net of allowances of $0 at both July 1, 2017 and at December 31, 2016	26,635	17,447
Inventories	26,834	24,876
Prepaid expenses and other current assets	2,156	1,768
Total current assets	89,417	88,736
Property, plant and equipment, net	12,244	11,237
Long-term investments	7,568	3,593
Restricted cash	1,400	1,602
Intangible assets, net of amortization of $6,556 at July 1, 2017 and $6,129 at December 31, 2016	1,831	2,258
Deferred income taxes and other long-term assets	743	898
Total assets	$ 113,203	$ 108,324
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 9,529	$ 5,323
Accrued payroll and related liabilities	6,010	4,220
Other accrued liabilities	3,044	17,011
Customer advances	13,178	5,422
Total current liabilities	31,761	31,976
Other long-term liabilities	3,335	3,082
Stockholders equity:		
Common stock, $0.001 par value	22	21
Additional paid-in capital	174,245	171,314

Treasury stock, 4,845 shares at both July 1, 2017 and December 31, 2016	(28,489)	(28,489)
Accumulated other comprehensive income	399	321
Accumulated deficit	(68,070)	(69,901)
Total stockholders equity	78,107	73,266
Total liabilities and stockholders equity	$ 113,203	$ 108,324

Note: Amounts as of December 31, 2016 are derived from the December 31, 2016 audited consolidated financial statements.

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
	(Unaudited)			
	(In thousands, except per share amounts)			
Net revenues:				
Systems and components	$ 29,863	$ 13,083	$ 58,286	$ 26,364
Technology development	1,100	1,835	3,065	2,218
Total net revenues	30,963	14,918	61,351	28,582
Cost of net revenues:				
Systems and components	18,345	7,514	34,018	16,465
Technology development	1,148	1,277	2,816	2,135
Total cost of net revenues	19,493	8,791	36,834	18,600
Gross profit	11,470	6,127	24,517	9,982
Operating expenses:				
Research and development	4,418	4,977	9,100	10,154
Selling, general and administrative	5,713	4,957	11,987	9,952
Total operating expenses	10,131	9,934	21,087	20,106
Income (loss) from operations	1,339	(3,807)	3,430	(10,124)
Interest income and other income (expense), net	127	87	237	125
Income (loss) before income taxes	1,466	(3,720)	3,667	(9,999)
Provision for (benefit from) income taxes	366	(230)	738	(204)
Net income (loss)	$ 1,100	$ (3,490)	$ 2,929	$ (9,795)
Net income (loss) per share:				
Basic	$ 0.05	$ (0.17)	$ 0.14	$ (0.48)
Diluted	$ 0.05	$ (0.17)	$ 0.13	$ (0.48)
Weighted average common shares outstanding:				
Basic	21,495	20,691	21,356	20,621
Diluted	23,209	20,691	22,999	20,621

See accompanying notes to the condensed consolidated financial statements.

4

Table of Contents

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
	(Unaudited) (In thousands)			
Net income (loss)	$ 1,100	$ (3,490)	$ 2,929	$ (9,795)
Other comprehensive income (loss), before tax:				
Change in unrealized net loss on available-for-sale investments	(1)	13	3	57
Foreign currency translation gains (losses)	41	(45)	75	22
Other comprehensive income (loss), before tax	40	(32)	78	79
Income taxes related to items in other comprehensive income (loss)				
Other comprehensive income (loss), net of tax	40	(32)	78	79
Comprehensive income (loss)	$ 1,140	$ (3,522)	$ 3,007	$ (9,716)

See accompanying notes to the condensed consolidated financial statements.

Table of Contents

INTEVAC, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six months ended	
	July 1, 2017	July 2, 2016
	(Unaudited) (In thousands)	
Operating activities		
Net income (loss)	$ 2,929	$ (9,795)
Adjustments to reconcile net income (loss) to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	1,973	2,658
Net amortization of investment premiums and discounts	54	63
Equity-based compensation	1,864	1,991
Change in the fair value of acquisition-related contingent consideration	102	(142)
Deferred income taxes	(1)	9
Changes in operating assets and liabilities	(10,937)	911
Total adjustments	(6,945)	5,490
Net cash and cash equivalents used in operating activities	(4,016)	(4,305)
Investing activities		
Purchases of investments	(15,608)	(7,736)
Proceeds from sales and maturities of investments	14,967	18,730
Decrease in restricted cash	202	
Purchases of leasehold improvements and equipment	(2,553)	(2,039)
Net cash and cash equivalents provided by (used in) investing activities	(2,992)	8,955
Financing activities		
Net proceeds from issuance of common stock	1,452	715
Taxes paid related to net share settlement	(1,985)	(401)
Payment of acquisition-related contingent consideration	(2)	
Net cash and cash equivalents provided by (used in) financing activities	(535)	314
Effect of exchange rate changes on cash and cash equivalents	75	23
Net increase (decrease) in cash and cash equivalents	(7,468)	4,987
Cash and cash equivalents at beginning of period	27,043	13,746
Cash and cash equivalents at end of period	$ 19,575	$ 18,733

See accompanying notes to the condensed consolidated financial statements.

6

Table of Contents

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Basis of Presentation

In the opinion of management, the unaudited interim condensed consolidated financial statements of Intevac, Inc. and its subsidiaries (Intevac or the Company) included herein have been prepared on a basis consistent with the December 31, 2016 audited consolidated financial statements and include all material adjustments, consisting of normal recurring adjustments, necessary to fairly present the information set forth therein. These unaudited interim condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in Intevac s Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (2016 Form 10-K). Intevac s results of operations for the three and six months ended July 1, 2017 are not necessarily indicative of future operating results.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ materially from those estimates.

2. Recent Accounting Pronouncements

In May 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2017-09, *Compensation - Stock Compensation: Scope of Modification Accounting*, which provides guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. An entity will account for the effects of a modification unless the fair value of the modified award is the same as the original award, the vesting conditions of the modified award are the same as the original award and the classification of the modified award as an equity instrument or liability instrument is the same as the original award. This update becomes effective and will be adopted by Intevac in the first quarter of fiscal 2019. The update is to be adopted prospectively to an award modified on or after the adoption date. Early adoption is permitted. Intevac does not expect the adoption of this update to have a material impact on its consolidated financial statements.

In March 2017, the FASB issued ASU 2017-08, *Receivables Nonrefundable Fees and Other Costs (Subtopic 310-20): Premium Amortization on Purchased Callable Debt Securities*. ASU 2017-08 amends the amortization period for certain purchased callable debt securities held at a premium, shortening such period to the earliest call date. This update becomes effective and will be adopted by Intevac in the first quarter of fiscal 2019. Intevac does not expect the adoption of this update to have a material impact on its consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, *Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment*. ASU 2017-04 eliminates Step 2 from the goodwill impairment test. Under Step 2, an entity had to perform procedures to determine the fair value at the impairment testing date of its assets and liabilities (including unrecognized assets and liabilities) following the procedure that would be required in determining the fair value of assets acquired and liabilities assumed in a business combination. Instead, under the amendments in ASU 2017-04, an entity should perform its annual, or interim, goodwill impairment test by comparing the fair value of a reporting unit with its carrying amount. An entity should recognize an impairment charge for the amount by which the carrying amount exceeds the reporting unit s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. Additionally, an entity should consider income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit when measuring the goodwill impairment loss, if applicable. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. This update becomes effective and will be adopted by Intevac in the first quarter of fiscal 2020. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. Intevac does not expect the adoption of this update to have a material impact on its consolidated financial statements.

Table of Contents

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In March 2016, the FASB issued ASU 2016-09 *Compensation Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*. We have adopted these amendments beginning in the first quarter of 2017. Starting in the first quarter of fiscal 2017, stock-based compensation excess tax benefits or deficiencies are reflected in the Condensed Consolidated Statements of Operations as a component of the provision for income taxes, whereas they previously were recognized in equity. Additionally, our Condensed Consolidated Statements of Cash Flows now presents excess tax benefits as an operating activity. Finally, we have elected to account for forfeitures as they occur, rather than estimate expected forfeitures. The net cumulative effect of this change was recognized as a $1.1 million charge to the accumulated deficit as of January 1, 2017. In the first half of 2017, stock-based compensation excess tax benefits of $74,000 were reflected in the Condensed Consolidated Statements of Operations as a component of the provision for income taxes.

In May 2014, the FASB issued ASU 2014-09 *(Topic 606) Revenue from Contracts with Customers.* Topic 606 supersedes the revenue recognition requirements in Accounting Standards Codification Topic 605, Revenue Recognition , and requires entities to recognize revenue when they transfer control of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled to in exchange for those goods or services. We expect revenue recognition for our equipment sales arrangements, which includes systems, technology upgrades, service and spare parts, to remain materially consistent with our historical practice.

We expect to recognize revenue for equipment sales at a point in time following the transfer of control of such products to the customer, which typically occurs upon shipment or delivery depending on the terms of the underlying contracts. Our contracts with customers may include multiple performance obligations. For such arrangements, we expect to allocate revenue to each performance obligation based on its relative standalone selling price. We generally determine standalone selling prices based on the prices charged to customers or using expected cost plus margin. The expected costs associated with our base warranties will continue to be recognized as expense when the equipment is sold.

We expect to recognize revenue for cost plus fixed fee and firm fixed priced government contracts over time under the cost-to-cost method for the majority of our government contracts, which is consistent with our current revenue recognition model. Revenue on the majority of our government contracts will continue to be recognized over time because of the continuous transfer of control to the customer. For U.S. government contracts, this continuous transfer of control to the customer is supported by clauses in the contract that allow the customer to unilaterally terminate the contract for convenience, pay us for costs incurred plus a reasonable profit and take control of any work in process. Similarly, for non-U.S. government contracts, the customer typically controls the work in process as evidenced either by contractual termination clauses or by our rights to payment for work performed to date to deliver products or services that do not have an alternative use to the company. Under the new standard, the cost-to-cost measure of progress continues to best depict the transfer of control of assets to the customer, which occurs as we incur costs.

The new standard must be adopted by Intevac in our fiscal year beginning December 31, 2017. We intend to adopt the new standard as of December 31, 2017, using the modified retrospective transition method applied to those contracts which were not completed as of that date. Upon adoption, we will recognize the cumulative effect of adopting this guidance as an adjustment to our opening balance of the accumulated deficit. Prior periods will not be retrospectively adjusted. Based on our preliminary assessment, we expect the adoption of Topic 606 will not have a material impact to our consolidated financial statements, including the presentation of revenues in our Consolidated Statements of Operations. We also do not expect the standard to have a material impact on our Consolidated Balance Sheet. The immaterial impact primarily relates to reclassifications among financial statement accounts to align with the new standard. Most notably, contracts in process, net will be reclassified as receivables or contract assets based on amounts billed or unbilled, respectively. Advance payments and billings in excess of costs incurred and deferred revenue will be combined and reclassified as contract liabilities. Our contract balances will be reported in a net contract asset or liability position on a contract-by-contract basis at the end of each reporting period.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

3. Inventories

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

	July 1, 2017	December 31, 2016
	(In thousands)	
Raw materials	$ 16,349	$ 10,290
Work-in-progress	9,880	6,470
Finished goods	605	8,116
	$ 26,834	$ 24,876

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

4. Equity-Based Compensation

At July 1, 2017, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan and the 2004 Equity Incentive Plan (together, the Plans) and the 2003 Employee Stock Purchase Plan (the ESPP). Intevac s stockholders approved all of these plans. The Plans permit the grant of incentive or non-statutory stock options, restricted stock, stock appreciation rights, restricted stock units (RSUs) and performance shares.

The ESPP provides that eligible employees may purchase Intevac s common stock through payroll deductions at a price equal to 85% of the lower of the fair market value at the entry date of the applicable offering period or at the end of each applicable purchase interval. 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. Under the terms of the ESPP, employees can choose to have up to 15% of their base earnings withheld to purchase Intevac common stock.

Compensation Expense

The effect of recording equity-based compensation for the three and six months ended July 1, 2017 and July 2, 2016 was as follows:

	Three Months Ended	Six Months Ended

	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
		(In thousands)		
Equity-based compensation by type of award:				
Stock options	$ 202	$ 209	$ 458	$ 485
RSUs	495	480	1,212	1,114
Employee stock purchase plan	90	191	194	392
Total equity-based compensation	$ 787	$ 880	$ 1,864	$ 1,991

Equity-based compensation expense is based on awards ultimately expected to vest and such amount has been historically reduced for estimated forfeitures. Beginning January 1, 2017, Intevac accounts for forfeitures as they occur, rather than estimate expected forfeitures. The net cumulative effect of this change was recognized as a $1.1 million increase to the accumulated deficit as of January 1, 2017.

Table of Contents

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Stock Options and ESPP

The fair value of stock options and ESPP awards is estimated at the grant date using the Black-Scholes option valuation model. The determination of fair value of stock options and ESPP awards on the date of grant using an option-pricing model is affected by Intevac s 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.

Option activity as of July 1, 2017 and changes during the six months ended July 1, 2017 were as follows:

	Shares	Weighted Average Exercise Price
Options outstanding at December 31, 2016	2,740,364	$ 7.00
Options granted	383,825	$ 12.42
Options cancelled and forfeited	(39,604)	$ 11.82
Options exercised	(101,954)	$ 7.03
Options outstanding at July 1, 2017	2,982,631	$ 7.63
Options exercisable at July 1, 2017	2,109,908	$ 7.22

Intevac issued 195,184 shares under the ESPP during the six months ended July 1, 2017.

Intevac estimated the weighted-average fair value of stock options and employee stock purchase rights using the following weighted-average assumptions:

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Stock Options:				
Weighted-average fair value of grants per share	$ 4.64	$ 1.75	$ 4.63	$ 1.74
Expected volatility	41.79%	44.14%	40.43%	44.11%
Risk free interest rate	1.87%	0.94%	1.77%	0.94%
Expected term of options (in years)	4.4	4.3	4.1	4.3
Dividend yield	None	None	None	None

	Six Months Ended	
	July 1, 2017	**July 2, 2016**
Stock Purchase Rights:		
Weighted-average fair value of grants per share	$ 2.74	$ 1.54
Expected volatility	40.66%	39.33%
Risk free interest rate	1.14%	0.76%
Expected term of purchase rights (in years)	0.74	1.93
Dividend yield	None	None

The computation of the expected volatility assumptions used in the Black-Scholes calculations for new stock option grants and ESPP purchase rights is based on the historical volatility of Intevac s stock price, measured over a period equal to the expected term of the stock option 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 equity-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 Intevac s history of not paying dividends and the assumption of not paying dividends in the future.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

RSUs

A summary of the RSU activity is as follows:

	Shares		Weighted Average Grant Date Fair Value
Non-vested RSUs at December 31, 2016	949,455	$	4.64
Granted	334,221	$	11.45
Vested	(499,527)	$	4.46
Cancelled and forfeited	(4,249)	$	6.72
Non-vested RSUs at July 1, 2017	779,900	$	7.66

Time-based RSUs are converted into shares of Intevac common stock upon vesting on a one-for-one basis. Time-based RSUs typically are scheduled to vest over four years. Vesting of time-based RSUs is subject to the grantee s continued service with Intevac. The compensation expense related to these awards is determined using the fair market value of Intevac common stock on the date of the grant, and the compensation expense is recognized over the vesting period.

Market condition-based RSUs vest upon the achievement of certain market conditions (our stock performance) during a set performance period (typically five years) subject to the grantee s continued service with Intevac through the date the applicable market condition is achieved. The fair value is based on the values calculated under the Monte Carlo simulation model on the grant date. Compensation cost is not adjusted in future periods for subsequent changes in the expected outcome of market related conditions. The compensation expense is recognized over the derived service period. We granted 125,000 of such awards to certain executive officers in the six months ended July 2, 2016. These awards have a derived service period of 2.8 years.

Intevac estimated the weighted-average fair value of market condition-based RSUs using the following weighted-average assumptions:

		Six Months Ended July 2, 2016
Weighted-average fair value of grants per share	$	2.46

Expected volatility	47.65%
Risk free interest rate	1.35%
Expected term (in years)	4.79
Dividend yield	None

In fiscal 2016, the annual bonus for certain participants in the Company s annual incentive plan was settled with RSUs with one-year vesting. The Company accrued for the payment of bonuses at the expected company-wide payout percentage amount at July 2, 2016, which amounts were less than the target bonus amounts for each participant. The bonus accrual was classified as a liability until the number of shares is determined on the date the awards were granted, at which time the Company classified the awards into equity. In February 2017, the annual 2016 bonus for certain participants was settled with RSUs with one-year vesting. 33 participants were granted stock awards to receive an aggregate of 134,000 shares of common stock with a weighted average grant date fair value of

Table of Contents

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

$9.63 per share. In February 2016, the annual 2015 bonus for certain participants was settled with RSUs with one-year vesting. 34 participants were granted stock awards to receive an aggregate of 266,000 shares of common stock with a weighted average grant date fair value of $4.40 per share. The Company recorded equity-based compensation expense related to the annual incentive plans of $102,000 for the six months ended July 1, 2017. The Company recorded equity-based compensation expense related to the annual incentive plan of $129,000 and $243,000, respectively, for the three and six months ended July 2, 2016.

5. Purchased Intangible Assets

Details of finite-lived intangible assets by segment as of July 1, 2017, are as follows.

	July 1, 2017		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
	(In thousands)		
Thin-film Equipment	$ 7,172	$ (5,505)	$ 1,667
Photonics	1,215	(1,051)	164
	$ 8,387	$ (6,556)	$ 1,831

Total amortization expense of finite-lived intangibles for the three and six months ended July 1, 2017 was $213,000 and $427,000.

As of July 1, 2017, future amortization expense is expected to be as follows.

(In thousands)	
2017	$ 328
2018	615
2019	615
2020	273
	$ 1,831

6. Acquisition-Related Contingent Consideration

In connection with the acquisition of Solar Implant Technologies, Inc. (SIT), Intevac agreed to pay to the selling shareholders in cash a revenue earnout on Intevac s net revenue from commercial sales of certain products over a specified period up to an aggregate of $9.0 million. Intevac estimated the fair value of this contingent consideration on July 1, 2017 based on probability-based forecasted revenues reflecting Intevac s own assumptions concerning future revenue from such products. As of July 1, 2017, payments made associated with the revenue earnout obligation have not been significant.

The fair value measurement of contingent consideration is based on significant inputs not observed in the market and thus represents a Level 3 measurement. Any change in fair value of the contingent consideration subsequent to the acquisition date is recognized in operating income within the condensed consolidated statement of operations. The following table represents a reconciliation of the change in the fair value measurement of the contingent consideration liability for the three and six months ended July 1, 2017 and July 2, 2016:

Table of Contents

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
	(In thousands)			
Opening balance	$ 837	$ 906	$ 759	$ 890
Changes in fair value	22	(158)	102	(142)
Cash payments made			(2)	
Closing balance	$ 859	$ 748	$ 859	$ 748

The following table displays the balance sheet classification of the contingent consideration liability account at July 1, 2017 and at December 31, 2016:

	July 1, 2017	December 31, 2016
	(In thousands)	
Other accrued liabilities	$ 208	$ 329
Other long-term liabilities	651	430
Total acquisition-related contingent consideration	$ 859	$ 759

The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the continent consideration liability as of July 1, 2017. Significant increases or decreases in any of these inputs in isolation would result in a significantly lower (higher) fair value measurement.

	Quantitative Information about Level 3 Fair Value Measurements at July 1, 2017			
	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
	(In thousands, except for percentages)			
Revenue Earnout	$ 859	Discounted cash flow	Weighted average cost of capital	15.3%
			Probability weighting of achieving revenue forecasts	10.0% - 80.0% (31.9%)

7. Warranty

Intevac provides for the estimated cost of warranty when revenue is recognized. Intevac s warranty is per contract terms and for its disk manufacturing, solar photovoltaic (PV) manufacturing and display cover panel (DCP) manufacturing systems the warranty typically ranges between 12 and 24 months from customer acceptance. During this warranty period any defective non-consumable parts are replaced and installed at no charge to the customer. Intevac uses estimated repair or replacement costs along with its historical warranty experience to determine its warranty obligation. Intevac generally provides a twelve month warranty on its Photonics products. The provision for the estimated future costs of warranty is based upon historical cost and product performance experience. Intevac exercises judgment in determining the underlying estimates.

On the condensed consolidated balance sheets, 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 statements of operations.

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table displays the activity in the warranty provision account for the three and six months ended July 1, 2017 and July 2, 2016:

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
	(In thousands)			
Opening balance	$ 1,106	$ 776	$ 1,007	$ 982
Expenditures incurred under warranties	(138)	(106)	(280)	(303)
Accruals for product warranties issued during the reporting period	256	61	506	174
Adjustments to previously existing warranty accruals	(4)	(139)	(13)	(261)
Closing balance	$ 1,220	$ 592	$ 1,220	$ 592

The following table displays the balance sheet classification of the warranty provision account at July 1, 2017 and at December 31, 2016:

	July1, 2017	December 31, 2016
	(In thousands)	
Other accrued liabilities	$ 1,014	$ 829
Other long-term liabilities	206	178
Total warranty provision	$ 1,220	$ 1,007

8. Guarantees

Officer and Director Indemnifications

As permitted or required under Delaware law and to the maximum extent allowable under that law, Intevac has certain obligations to indemnify its current and former officers and directors for certain events or occurrences while the officer or director is, or was, serving at Intevac s request in such capacity. These indemnification obligations are valid as long as the director or officer acted in good faith and in a manner the person reasonably believed to be in or not opposed to the best interests of the Company and, with respect to any criminal action or proceeding, had no reasonable cause to believe his or her conduct was unlawful. The maximum potential amount of future payments Intevac could be required to make under these indemnification obligations is unlimited; however, Intevac has a director and officer insurance policy that mitigates Intevac s exposure and enables Intevac to recover a portion of any future amounts paid. As a result of Intevac s insurance policy coverage, Intevac believes the estimated fair value of these indemnification obligations is not material.

Other Indemnifications

As is customary in Intevac s industry, many of Intevac s contracts provide remedies to certain third parties such as defense, settlement, or payment of judgments for intellectual property claims related to the use of its products. Such indemnification obligations may not be subject to maximum loss clauses. Historically, payments made related to these indemnifications have been immaterial.

Letters of Credit

As of July 1, 2017, we had letters of credit and bank guarantees outstanding totaling $1.4 million, including a standby letter of credit outstanding under the Santa Clara, California facility lease and various other guarantees with our bank. These letters of credit and bank guarantees are collateralized by $1.4 million of restricted cash.

Table of Contents

INTEVAC, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

9. Cash, Cash Equivalents and Investments

Cash and cash equivalents, short-term investments and long-term investments consist of:

	July 1, 2017			
	Amortized Cost	Unrealized Holding Gains	Unrealized Holding Losses	Fair Value
	(In thousands)			
Cash and cash equivalents:				
Cash	$ 11,730	$	$	$ 11,730
Money market funds	6,097			6,097
Municipal bonds	999			999
U.S. treasury and agency securities	749			749
Total cash and cash equivalents	$ 19,575	$	$	$ 19,575
Short-term investments:				
Certificates of deposit	$ 2,500	$	$	$ 2,500
Commercial paper	1,494			1,494
Corporate bonds and medium-term notes	6,200		5	6,195
Municipal bonds	510		1	509
U.S. treasury and agency securities	3,519			3,519
Total short-term investments	$ 14,223	$	$ 6	$ 14,217
Long-term investments:				
Corporate bonds and medium-term notes	$ 4,486	$	$ 8	$ 4,478
Municipal bonds	500		3	497
U.S. treasury and agency securities	2,595		2	2,593
Total long-term investments	$ 7,581	$	$ 13	$ 7,568
Total cash, cash equivalents, and investments	$ 41,379	$	$ 19	$ 41,360

	December 31, 2016			
	Amortized Cost	Unrealized Holding	Unrealized Holding	Fair Value

		Gains	Losses	
		(in thousands)		
Cash and cash equivalents:				
Cash	$ 18,726	$	$	$ 18,726
Money market funds	8,317			8,317
Total cash and cash equivalents	$ 27,043	$	$	$ 27,043
Short-term investments:				