

INTEVAC INC
Form 10-Q
November 01, 2012
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 September 29, 2012

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
(State or other jurisdiction of
incorporation or organization)

94-3125814
(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

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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, 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 Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if a smaller reporting company)

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

On November 1, 2012, 23,464,809 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

Table of Contents

INTEVAC, INC.

INDEX

	Page No.
<u>PART I. FINANCIAL INFORMATION</u>	
Item 1.	
<u>Financial Statements (unaudited)</u>	
<u>Condensed Consolidated Balance Sheets</u>	3
<u>Condensed Consolidated Statements of Operations</u>	4
<u>Condensed Consolidated Statements of Comprehensive Income (Loss)</u>	5
<u>Condensed Consolidated Statements of Cash Flows</u>	6
<u>Notes to Condensed Consolidated Financial Statements</u>	7
Item 2.	
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	23
Item 3.	
<u>Quantitative and Qualitative Disclosures About Market Risk</u>	31
Item 4.	
<u>Controls and Procedures</u>	31
<u>PART II. OTHER INFORMATION</u>	
Item 1.	
<u>Legal Proceedings</u>	32
Item 1A.	
<u>Risk Factors</u>	33
Item 2.	
<u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	40
Item 3.	
<u>Defaults Upon Senior Securities</u>	40
Item 4.	
<u>Mine Safety Disclosures</u>	40
Item 5.	
<u>Other Information</u>	40
Item 6.	
<u>Exhibits</u>	40
<u>SIGNATURES</u>	42

Table of Contents**PART I. FINANCIAL INFORMATION****Item 1. Financial Statements****INTEVAC, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

	September 29, 2012	December 31, 2011
	(Unaudited)	
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 16,859	\$ 23,560
Short-term investments	51,566	58,585
Trade, note and other accounts receivable, net of allowances of \$0 at September 29, 2012 and of \$41 at December 31, 2011	16,528	18,561
Inventories	24,479	18,070
Prepaid expenses and other current assets	7,150	7,114
Deferred income tax assets	2,547	2,202
Total current assets	119,129	128,092
Property, plant and equipment, net	13,234	14,449
Long-term investments	30,356	32,677
Goodwill	18,389	18,389
Other intangible assets, net of amortization of \$2,751 at September 29, 2012 and \$2,344 at December 31, 2011	6,034	6,441
Deferred income taxes and other long-term assets	27,915	25,773
Total assets	\$ 215,057	\$ 225,821
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 6,166	\$ 4,857
Accrued payroll and related liabilities	4,644	4,205
Other accrued liabilities	7,751	9,887
Customer advances	2,819	5,040
Total current liabilities	21,380	23,989
Other long-term liabilities	9,419	9,922
Stockholders' equity:		
Common stock, \$0.001 par value	23	23
Additional paid-in capital	151,113	146,307
Accumulated other comprehensive income	617	414
Retained earnings	32,505	45,166
Total stockholders' equity	184,258	191,910
Total liabilities and stockholders' equity	\$ 215,057	\$ 225,821

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Note: Amounts as of December 31, 2011 are derived from the December 31, 2011 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		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(Unaudited)			
	(In thousands, except per share amounts)			
Net revenues:				
Systems and components	\$ 11,665	\$ 17,788	\$ 55,067	\$ 59,012
Technology development	5,169	1,533	10,874	5,317
Total net revenues	16,834	19,321	65,941	64,329
Cost of net revenues:				
Systems and components	7,476	10,693	31,561	36,747
Technology development	3,626	1,110	7,569	3,547
Total cost of net revenues	11,102	11,803	39,130	40,294
Gross profit	5,732	7,518	26,811	24,035
Operating expenses:				
Research and development	7,336	8,612	24,812	25,914
Selling, general and administrative	6,389	6,945	19,831	20,336
Bad debt expense	3,017	34	3,017	36
Total operating expenses	16,742	15,591	47,660	46,286
Gain on sale of mainframe technology			2,207	
Loss from operations	(11,010)	(8,073)	(18,642)	(22,251)
Interest income and other, net	(8)	140	411	438
Loss before income taxes	(11,018)	(7,933)	(18,231)	(21,813)
Benefit from income taxes	(3,011)	(1,817)	(5,570)	(6,047)
Net loss	\$ (8,007)	\$ (6,116)	\$ (12,661)	\$ (15,766)
Net loss per share:				
Basic and diluted	\$ (0.34)	\$ (0.27)	\$ (0.54)	\$ (0.69)
Weighted average common shares outstanding:				
Basic and diluted	23,397	22,951	23,293	22,843

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**INTEVAC, INC.****CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)**

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(Unaudited)			
	(In thousands, except per share amounts)			
Net loss	\$ (8,007)	\$ (6,116)	\$ (12,661)	\$ (15,766)
Other comprehensive income (loss), before tax				
Change in unrealized net loss on available-for-sale investments	73	(46)	305	267
Foreign currency translation gains (losses)	19	(13)	5	3
Other comprehensive income (loss), before tax	92	(59)	310	270
Income tax (expense) benefit related to items in other comprehensive income (loss)	(26)	16	(107)	(94)
Other comprehensive income (loss), net of tax	66	(43)	203	176
Comprehensive loss	\$ (7,941)	\$ (6,159)	\$ (12,458)	\$ (15,590)

See accompanying notes to the condensed consolidated financial statements.

Table of Contents**INTEVAC, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine months ended	
	September 29, 2012	October 1, 2011
	(Unaudited)	
	(In thousands)	
Operating activities		
Net loss	\$ (12,661)	\$ (15,766)
Adjustments to reconcile net loss to net cash and cash equivalents used in operating activities:		
Depreciation and amortization	3,391	4,109
Net amortization of investment premiums and discounts	1,076	982
Net loss on sale of investments	210	283
Bad debt expense	3,017	36
Equity-based compensation	2,941	3,061
Change in the fair value of acquisition-related contingent consideration	443	917
Deferred income taxes	(5,418)	(6,619)
Gain on sale of mainframe technology	(2,207)	
Loss (gain) on disposal of equipment	168	(109)
Changes in operating assets and liabilities	(5,430)	3,044
Total adjustments	(1,809)	5,704
Net cash and cash equivalents used in operating activities	(14,470)	(10,062)
Investing activities		
Purchases of investments	(32,987)	(99,599)
Proceeds from sales and maturities of investments	41,346	32,338
Proceeds from sale of equipment		241
Proceeds from sale of mainframe technology	3,000	
Purchases of leasehold improvements and equipment	(2,114)	(4,744)
Net cash and cash equivalents provided by (used in) investing activities	9,245	(71,764)
Financing activities		
Payment of acquisition-related contingent consideration	(3,345)	(2,389)
Net proceeds from issuance of common stock	1,865	2,625
Net cash and cash equivalents provided by (used in) financing activities	(1,480)	236
Effect of exchange rate changes on cash	4	3
Net decrease in cash and cash equivalents	(6,701)	(81,587)
Cash and cash equivalents at beginning of period	23,560	109,520
Cash and cash equivalents at end of period	\$ 16,859	\$ 27,933

See accompanying notes to the condensed consolidated financial statements.

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, 2011 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, 2011 (2011 Form 10-K). Intevac's results of operations for the three and nine months ended September 29, 2012 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 Pronouncement

In July 2012, the Financial Accounting Standards Board amended its existing guidance for goodwill and other intangible assets. This authoritative guidance gives companies the option to first perform a qualitative assessment to determine whether it is more likely than not that an indefinite-lived intangible asset is impaired. To perform a qualitative assessment, a company must identify and evaluate changes in economic, industry and company-specific events and circumstances that could affect the significant inputs used to determine the fair value of an indefinite-lived intangible asset. If a company determines that it is more likely than not that the fair value of such an asset exceeds its carrying amount, it would not need to calculate the fair value of the asset in that year. This authoritative guidance becomes effective for Intevac in the first quarter of fiscal 2013, with early adoption permitted. The implementation of this authoritative guidance is not expected to have a material impact on Intevac's financial position or results of operations.

3. Inventories

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

	September 29, 2012	December 31, 2011
	(In thousands)	
Raw materials	\$ 14,851	\$ 12,662
Work-in-progress	4,158	3,020
Finished goods	5,470	2,388
	\$ 24,479	\$ 18,070

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

Table of Contents**INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****4. Equity-Based Compensation**

At September 29, 2012, Intevac had equity-based awards outstanding under the 2012 Equity Incentive Plan and the 2004 Equity Incentive Plan (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 also referred to as performance units) 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 beginning 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 nine months ended September 29, 2012 and October 1, 2011 was as follows:

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(In thousands)			
Equity-based compensation by type of award:				
Stock options	\$ 523	\$ 729	\$ 1,843	\$ 2,221
RSUs	88		111	
Employee stock purchase plan	332	286	987	840
Total equity-based compensation	943	1,015	2,941	3,061
Tax effect on equity-based compensation	(205)	(261)	(706)	(823)
Net effect on net loss	\$ 738	\$ 754	\$ 2,235	\$ 2,238

Equity-based compensation expense is based on awards ultimately expected to vest and such amount has been reduced for estimated forfeitures. Forfeitures were estimated based on Intevac s historical experience, which Intevac believes to be indicative of Intevac s future experience.

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.

Table of Contents**INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

Option activity as of September 29, 2012 and changes during the nine months ended September 29, 2012 were as follows:

	Shares	Weighted Average Exercise Price
Options outstanding at December 31, 2011	3,391,925	\$ 12.03
Options granted	384,505	\$ 7.67
Options forfeited	(359,109)	\$ 13.55
Options exercised	(41,412)	\$ 3.35
Options outstanding at September 29, 2012	3,375,909	\$ 11.47
Vested and expected to vest at September 29, 2012	3,221,395	\$ 11.57
Options exercisable at September 29, 2012	2,343,746	\$ 12.33

Intevac issued 301,000 shares under the ESPP during the nine months ended September 29, 2012.

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

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Stock Options:				
Weighed-average fair value of grants per share	\$ 2.87	\$ 3.99	\$ 3.90	\$ 6.10
Expected volatility	63.19%	64.87%	63.80%	64.70%
Risk free interest rate	0.41%	0.84%	0.74%	1.77%
Expected term of options (in years)	3.94	4.50	4.63	4.76
Dividend yield	None	None	None	None

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
Stock Purchase Rights:				
Weighed-average fair value of grants per share	\$ 2.31	\$ 3.60	\$ 3.01	\$ 4.84
Expected volatility	63.23%	48.87%	62.36%	51.63%
Risk free interest rate	0.21%	0.19%	0.28%	0.44%
Expected term of purchase rights (in years)	1.85	1.85	1.68	1.36
Dividend yield	None	None	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 Intevac's 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 equity-based awards and vesting schedules. The expected term of purchase rights represents the period of time remaining in the current offering period.

Table of Contents**INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The dividend yield assumption is based on Intevac's history of not paying dividends and the assumption of not paying dividends in the future.

RSUs

During the nine months ended September 29, 2012, Intevac granted 101,000 RSUs with a weighted-average estimated fair value of \$7.56 per share. RSUs are converted into shares of Intevac common stock upon vesting on a one-for-one basis. RSUs typically are scheduled to vest over four years. Vesting of 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.

5. Allowance for Doubtful Accounts

The following table represents a reconciliation of the allowance for doubtful accounts for the three- and nine month periods ended September 29, 2012 and October 1, 2011:

	Three Months Ended		Nine Months Ended	
	September 29, 2012	October 1, 2011	September 29, 2012	October 1, 2011
	(In thousands)			
Opening balance	\$	\$ 55	\$ 41	\$ 55
Bad debt expense	3,017	34	3,017	36
Write-offs	(3,017)	(48)	(3,058)	(50)
Closing balance	\$	\$ 41	\$	\$ 41

Intevac held a promissory note from a customer which was secured by the equipment sold to this customer in a prior year under a product and sales agreement. The note was to be repaid in monthly installment payments ending in March 2015. The revenue associated with this sale had been accounted for under the installment method of accounting whereby revenue was recognized only to the extent cash had been received. During the quarter ended September 29, 2012, the customer became delinquent in its monthly installment payments and the note was put on non-accrual status. On September 27, 2012, the customer liquidated its operating assets in an auction. The equipment which collateralized the promissory note was sold in the liquidation auction and Intevac received the proceeds. On September 28, 2012, the customer announced that it was discontinuing its operations effective October 9, 2012 and Intevac concluded that none of the carrying value of the promissory note receivable was collectible and recorded a bad debt charge.

Intevac evaluates the collectibility of trade accounts receivables and notes receivable on an ongoing basis and provides reserves against potential losses when appropriate. Management analyzes historical bad debts, customer concentrations, customer creditworthiness, changes in customer payment tendencies and current economic trends when evaluating the adequacy of the allowance for doubtful accounts. Customer accounts are written off against the allowance when the amount is deemed uncollectible.

The following table summarizes the components of the bad debt expense for the three- and nine month periods ended September 29, 2012 (in thousands):

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Promissory note	\$ 4,085
Deferred profit on installment sale	(1,028)
Cash recovery from liquidation sale	(40)
Bad debt expense	\$ 3,017

Table of Contents**INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****6. Goodwill and Purchased Intangible Assets**

Goodwill and indefinite-life intangible assets are tested for impairment on an annual basis or more frequently upon the occurrence of circumstances that indicate that goodwill and indefinite-life intangible assets may be impaired. In the fourth quarter of fiscal 2011, Intevac performed its annual impairment analysis and the results of the analysis indicated that Intevac's goodwill and purchased intangible assets with an indefinite useful life were not impaired.

Details of goodwill and indefinite-lived intangible assets by segment as of September 29, 2012, are as follows.

	September 29, 2012		
	Goodwill	Other Intangible Assets (In thousands)	Total
Equipment	\$ 10,484	\$ 4,000	\$ 14,484
Intevac Photonics	7,905	120	8,025
	\$ 18,389	\$ 4,120	\$ 22,509

Other intangible assets consist primarily of in-process technology, which will be subject to amortization upon commercialization. If an in-process technology is abandoned, the acquired technology will be written-off.

Details of finite-lived intangible assets by segment as of September 29, 2012, are as follows.

	September 29, 2012		
	Gross Carrying Amount	Accumulated Amortization (In thousands)	Net Carrying Amount
Equipment	\$ 3,170	\$ (1,923)	\$ 1,247
Intevac Photonics	1,495	(828)	667
	\$ 4,665	\$ (2,751)	\$ 1,914

Total amortization expense of finite-lived intangibles for the three and nine months ended September 29, 2012 was \$136,000 and \$407,000 respectively.

As of September 29, 2012, future amortization expense is expected to be as follows.

(In thousands)

2012	\$ 135
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2013	541
2014	363
2015	283
2016	281
Thereafter	311
	\$ 1,914

Table of Contents**INTEVAC, INC.****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****7. Acquisition-Related Contingent Consideration**

In connection with the acquisition of Solar Implant Technologies, Inc. (SIT) on November 19, 2010, Intevac agreed to pay up to an aggregate of \$7.0 million in cash to the selling shareholders if certain milestones are achieved over a specified period. Intevac has made payments to the selling shareholders for achievement of the first, second and third milestones. Intevac estimated the fair value of the remaining contingent consideration on September 29, 2012 using a discounted cash flow model based on the probability that the fourth and final remaining milestone would be met and the payment would be made on the targeted date outlined in the acquisition agreement.

In connection with the acquisition of SIT, Intevac also 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 September 29, 2012 based on probability-based forecasted revenues reflecting Intevac's own assumptions concerning future revenue from such products. A change in the estimated probabilities of revenue achievement could have a material effect on the statement of operations and balance sheets in the period of change.

The fair value measurement of contingent consideration is based on significant inputs not observable in the market and thus represents a Level 3 measurement. The following table represents the quantitative range of the significant unobservable inputs used in the calculation of fair value of the contingent consideration liability as of September 29, 2012. Significant increases or decreases in any of these inputs even in isolation would result in a significantly lower (higher) fair value measurement.

Quantitative Information about Level 3 Fair Value Measurements at September 29, 2012

	Fair Value	Valuation Technique	Unobservable Input	Range (Weighted Average)
			(In thousands, except for percentages)	
Milestone Payable	\$ 693	Discounted cash flow	Discount rate	4.7%
			Probability of achieving remaining milestone	97.5%
Revenue Earnout				