

KLA TENCOR CORP
Form 10-Q
April 30, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: March 31, 2010

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 0-09992

KLA-Tencor Corporation

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

04-2564110
(I.R.S. Employer
Identification No.)

One Technology Drive

Milpitas, California

95035

(Address of principal executive offices)

(Zip Code)

(408) 875-3000

(Registrant's telephone number, including area code)

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 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.

Large accelerated filer

Accelerated filer

Non-accelerated filer
(Do not check if a smaller
reporting company)

Smaller reporting company

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

As of April 15, 2010, there were 169,993,702 shares of the registrant's Common Stock, \$0.001 par value, outstanding.

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Table of Contents**PART I. FINANCIAL INFORMATION****ITEM 1. FINANCIAL STATEMENTS****KLA-TENCOR CORPORATION****Condensed Consolidated Balance Sheets**

<i>(In thousands)</i>	March 31, 2010 (unaudited)	June 30, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 543,505	\$ 524,967
Marketable securities	1,010,019	804,917
Accounts receivable, net	322,542	210,143
Inventories, net	374,435	370,206
Deferred income taxes	270,155	261,121
Other current assets	154,911	227,263
Total current assets	2,675,567	2,398,617
Land, property and equipment, net	243,758	291,878
Goodwill	328,177	329,379
Purchased intangibles, net	125,854	149,080
Other non-current assets	416,489	440,584
Total assets	\$ 3,789,845	\$ 3,609,538
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	\$ 91,645	\$ 63,485
Deferred system profit	166,956	95,820
Unearned revenue	33,142	46,236
Other current liabilities	395,019	341,441
Total current liabilities	686,762	546,982
Non-current liabilities:		
Long-term debt	745,611	745,204
Income tax payable	46,323	49,738
Unearned revenue	21,471	23,059
Other non-current liabilities	70,654	60,163
Total liabilities	1,570,821	1,425,146
Commitments and contingencies (Note 13 and Note 14)		
Stockholders' equity:		
Common stock and capital in excess of par value	898,155	835,477
Retained earnings	1,339,010	1,370,132
Accumulated other comprehensive income (loss)	(18,141)	(21,217)
Total stockholders' equity	2,219,024	2,184,392

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Total liabilities and stockholders' equity	\$ 3,789,845	\$ 3,609,538
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See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents**KLA-TENCOR CORPORATION****Condensed Consolidated Statements of Operations**

(Unaudited)

<i>(In thousands, except per share data)</i>	Three months ended		Nine months ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Revenues:				
Product	\$ 349,787	\$ 207,332	\$ 893,984	\$ 885,900
Service	128,512	102,280	367,357	352,814
Total revenues	478,299	309,612	1,261,341	1,238,714
Costs and operating expenses:				
Costs of revenues	208,565	209,223	587,743	700,203
Engineering, research and development	84,741	82,609	246,251	292,236
Selling, general and administrative	93,714	90,061	274,023	342,505
Goodwill and purchased intangible asset impairment				446,744
Total costs and operating expenses	387,020	381,893	1,108,017	1,781,688
Income (loss) from operations	91,279	(72,281)	153,324	(542,974)
Interest income and other, net	3,084	8,723	28,846	28,154
Interest expense	14,092	13,609	41,091	41,335
Income (loss) before income taxes	80,271	(77,167)	141,079	(556,155)
Provision for (benefit from) income taxes	23,255	5,660	41,864	(58,363)
Net income (loss)	\$ 57,016	\$ (82,827)	\$ 99,215	\$ (497,792)
Net income (loss) per share:				
Basic	\$ 0.33	\$ (0.49)	\$ 0.58	\$ (2.92)
Diluted	\$ 0.33	\$ (0.49)	\$ 0.57	\$ (2.92)
Cash dividend paid per share	\$ 0.15	\$ 0.15	\$ 0.45	\$ 0.45
Weighted average number of shares:				
Basic	171,506	169,934	171,202	170,349
Diluted	173,357	169,934	173,432	170,349

See accompanying notes to condensed consolidated financial statements (unaudited).

Table of Contents**KLA-TENCOR CORPORATION****Condensed Consolidated Statements of Cash Flows**

(Unaudited)

<i>(In thousands)</i>	Nine months ended March 31,	
	2010	2009
Cash flows from operating activities:		
Net income (loss)	\$ 99,215	\$ (497,792)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	67,794	110,116
Goodwill, purchased intangible asset and long-lived asset impairment charges	10,592	451,982
Gain on sale of real estate assets	(2,984)	(3,718)
Non-cash stock-based compensation	62,523	79,443
Provision for doubtful accounts		24,097
Tax charge from equity awards	(5,133)	(4,657)
Excess tax benefit from equity awards		(1,691)
Net loss (gain) on sale of marketable securities and other investments	(3,689)	475
Changes in assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Decrease (increase) in accounts receivable, net	(107,361)	240,070
Decrease (increase) in inventories	(1,254)	67,138
Decrease in other assets	75,299	58,672
Increase (decrease) in accounts payable	28,459	(53,516)
Increase (decrease) in deferred system profit	71,136	(76,610)
Increase (decrease) in other liabilities	69,925	(271,763)
Net cash provided by operating activities	364,522	122,246
Cash flows from investing activities:		
Acquisition of business, net of cash received	(1,500)	(141,399)
Capital expenditures, net	(24,411)	(20,246)
Proceeds from sale of assets	5,878	21,814
Purchase of available-for-sale securities	(863,289)	(659,547)
Proceeds from sale of available-for-sale securities	514,926	438,831
Proceeds from maturity of available-for-sale securities	129,036	77,333
Purchase of trading securities	(54,555)	(46,838)
Proceeds from sale of trading securities	64,975	52,240
Net cash used in investing activities	(228,940)	(277,812)
Cash flows from financing activities:		
Issuance of common stock	23,813	27,137
Tax withholding payments related to vested and released restricted stock units	(12,913)	(11,703)
Common stock repurchases	(54,630)	(226,515)
Payment of dividends to stockholders	(77,023)	(76,659)
Excess tax benefit from equity awards		1,691
Net cash used in financing activities	(120,753)	(286,049)
Effect of exchange rate changes on cash and cash equivalents	3,709	(21,562)

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Net increase (decrease) in cash and cash equivalents	18,538	(463,177)
Cash and cash equivalents at beginning of period	524,967	1,128,106
Cash and cash equivalents at end of period	\$ 543,505	\$ 664,929
Supplemental cash flow disclosures:		
Income tax refunds received, net	\$ (42,971)	\$ (17,870)
Interest paid	\$ 26,432	\$ 29,547

See accompanying notes to condensed consolidated financial statements (unaudited).

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KLA-TENCOR CORPORATION

Notes to Condensed Consolidated Financial Statements

(Unaudited)

NOTE 1 BASIS OF PRESENTATION

Basis of Presentation. The condensed consolidated financial statements have been prepared by KLA-Tencor Corporation ("KLA-Tencor" or the Company) pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC"). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the unaudited interim financial statements reflect all adjustments (consisting only of normal, recurring adjustments) necessary for a fair statement of the financial position, results of operations and cash flows for the periods indicated. These financial statements and notes, however, should be read in conjunction with Item 8, Financial Statements and Supplementary Data included in the Company's Annual Report on Form 10-K for the fiscal year ended June 30, 2009, filed with the SEC on August 7, 2009.

The condensed consolidated financial statements include the accounts of KLA-Tencor and its majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated. The Company has included the results of operations of acquired companies from the date of acquisition.

The results of operations for the three and nine months ended March 31, 2010 are not necessarily indicative of the results that may be expected for any other interim period or for the full fiscal year ending June 30, 2010.

Certain reclassifications have been made to the prior year's Condensed Consolidated Balance Sheet to conform to the current year presentation. The reclassifications had no effect on the Condensed Consolidated Statements of Operations or Cash Flows.

Management Estimates. The preparation of the condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Recent Accounting Pronouncements. In February 2010, the SEC issued a policy statement and staff work plan regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards ("IFRS"). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board. Under the proposed timeline set forth by the SEC, the Company could be required in fiscal year 2015 to prepare financial statements in accordance with IFRS, and the SEC is expected to make a determination in 2011 regarding the mandatory adoption of IFRS. The Company is currently assessing the impact that this potential change would have on its consolidated financial statements, and it will continue to monitor the development of the potential implementation of IFRS.

In February 2010, the Financial Accounting Standards Board ("FASB") amended its guidance on subsequent events. The amendment states that entities that are required to file or furnish their financial statements with the SEC are no longer required to disclose the date through which the entity has evaluated subsequent events. This amendment is effective for the Company's interim reporting period ended March 31, 2010, and the implementation did not have an impact on the Company's financial position, results of operations or cash flows as it is disclosure-only in nature.

In January 2010, the FASB issued authoritative guidance for fair value measurements. This guidance now requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and also to describe the reasons for these transfers. This authoritative guidance also requires enhanced disclosure of activity in Level 3 fair value measurements. The guidance for Level 1 and Level 2 fair value measurements is effective for the Company's interim reporting period ended March 31, 2010. The implementation did not have an impact on the Company's financial position, results of operations or cash flows as it is disclosure-only in nature. The guidance for Level 3 fair value measurements disclosures becomes effective for the Company's interim reporting period ending September 30, 2011, and the Company does not expect that this guidance will have an impact on its financial position, results of operations or cash flows as it is disclosure-only in nature.

In October 2009, the FASB amended its Emerging Issues Task Force ("EITF") authoritative guidance addressing revenue arrangements with multiple deliverables. The guidance requires revenue to be allocated to multiple elements using relative fair value based on vendor-specific objective evidence, third-party evidence or estimated selling price. The residual method also becomes obsolete under this guidance. This

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guidance is effective for the Company's interim reporting period ending September 30, 2010, and allows for early adoption. The Company elected to early adopt the accounting guidance at the beginning of the second quarter of its fiscal year ending June 30, 2010 and has applied the adoption retrospectively to the beginning of the fiscal year to apply the guidance to transactions originating or materially modified after June 30, 2009. The implementation resulted in additional qualitative disclosures but did not have a material impact on the Company's financial position, results of operations or cash flows.

In October 2009, the FASB amended the authoritative guidance addressing certain revenue arrangements that include software elements. This guidance states that tangible products with hardware and software components that work together to deliver the product

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functionality are considered non-software products, and the accounting guidance for revenue arrangements with multiple deliverables is to be followed with respect to such products. This guidance is effective for the Company's interim reporting period ending September 30, 2010, and allows for early adoption. The Company elected to early adopt the accounting guidance at the beginning of the second quarter of its fiscal year ending June 30, 2010 and has applied the adoption retrospectively to the beginning of the fiscal year to apply the guidance to transactions originating or materially modified after June 30, 2009. The implementation resulted in additional qualitative disclosures but did not have a material impact on the Company's financial position, results of operations or cash flows.

In August 2009, the FASB issued authoritative guidance for measuring liabilities at fair value that reaffirms the previously existing definition of fair value and reintroduces the concept of entry value into the determination of fair value of liabilities. Entry value is the amount an entity would receive to enter into an identical liability. The guidance was effective for the Company's interim reporting period ended December 31, 2009. The implementation did not have a material impact on the Company's financial position, results of operations or cash flows.

In June 2009, the FASB issued authoritative guidance for consolidations that changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. This guidance is effective for the Company's interim reporting period ending September 30, 2010. The Company is currently evaluating the impact of the guidance on its financial position, results of operations and cash flows.

In June 2009, the FASB issued authoritative guidance to establish the FASB Accounting Standards Codification as the source of authoritative accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This guidance was effective for the Company's interim reporting period ended September 30, 2009 and only impacted references for accounting guidance.

In April 2009, the FASB issued authoritative guidance for business combinations that amends the provisions related to the initial recognition and measurement, subsequent measurement and disclosure of assets and liabilities arising from contingencies in a business combination. This guidance will require such contingencies to be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the allocation period. Otherwise, entities would typically account for the acquired contingencies in accordance with authoritative guidance for contingencies. The guidance became effective for the Company's business combinations for which the acquisition date is on or after July 1, 2009. The Company did not complete any material business combinations during the three or nine months ended March 31, 2010, and the effect of this guidance, if any, on the Company's financial position, results of operations and cash flows in future periods will depend on the nature and significance of business combinations subject to this guidance.

In April 2009, the FASB issued authoritative guidance to increase the frequency of fair value disclosures of financial instruments, thereby enhancing consistency in financial reporting. The guidance relates to fair value disclosures for any financial instruments that are not currently reflected on a company's balance sheet at fair value. Prior to the effective date of this guidance, fair values for these types of financial assets and liabilities had only been disclosed once a year. The guidance requires these disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. The disclosure requirement under this guidance was effective for the Company's interim reporting period ended September 30, 2009. The implementation did not have an impact on the Company's financial position, results of operations or cash flows as it is disclosure-only in nature.

In December 2008, the FASB issued authoritative guidance for an employer's disclosures about plan assets of a defined benefit pension or other post-retirement plan. The guidance requires annual disclosures surrounding how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies. The annual disclosure requirement under this guidance is effective for the Company's fiscal year ending June 30, 2010. The guidance does not change the accounting treatment for post-retirement benefit plans.

In April 2008, the FASB issued authoritative guidance for general intangibles other than goodwill, amending the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This guidance is effective for intangible assets acquired on or after July 1, 2009. The adoption did not have a material impact on the Company's financial position, results of operations or cash flows.

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Revenue Recognition for Certain Arrangements with Software Elements and/or Multiple Deliverables

As discussed above, in October 2009, the FASB amended the accounting standards for revenue recognition to remove tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of industry-specific software revenue recognition guidance. In October 2009, the FASB also amended the accounting standards for multiple-deliverable revenue arrangements to:

provide updated guidance on how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and

require an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of deliverables if it does not have vendor-specific objective evidence (VSOE) or third-party evidence (TPE) of selling price. Valuation terms are defined as follows:

VSOE the price at which the Company sells the element in a separate stand-alone transaction.

TPE evidence from the Company or other companies of the value of a largely interchangeable element in a transaction.

ESP the Company's best estimate of the selling price of an element in a transaction.

The Company elected to early adopt this accounting guidance at the beginning of its second quarter of the fiscal year ending June 30, 2010 and has applied the adoption retrospectively to the beginning of the fiscal year to apply the guidance to transactions originating or materially modified after June 30, 2009. The implementation resulted in additional qualitative disclosures that are included below but did not have a material impact on the Company's financial position, results of operations or cash flows.

In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on revenues in periods after the initial adoption when applied to multiple element arrangements based on current sales strategies.

For transactions entered into through June 30, 2009, the Company primarily recognized revenue based on the guidance in Staff Accounting Bulletin No. 104. During the period, for the majority of the Company's arrangements involving multiple deliverables, the entire amount of the sales contract was allocated to each respective element based on its relative selling price, using fair value. In the limited circumstances when the Company was not able to determine fair value for the deliverables in the arrangement, but was able to obtain fair value for the undelivered elements, revenue was allocated using the residual method. Under the residual method, the amount of revenue allocated to delivered elements equaled the total arrangement consideration less the aggregate selling price of any undelivered elements, and no revenue was recognized until all elements without fair value had been delivered. If fair value of any undelivered elements did not exist, the entire amount of the sales contract was deferred until all elements were accepted by the customer.

This guidance does not generally change the units of accounting for the Company's revenue transactions. The Company typically recognizes revenue for system sales upon acceptance by the customer that the system has been installed and is operating according to predetermined specifications. Under certain circumstances, however, the Company recognizes revenue upon shipment, prior to written acceptance by the customer. The portion of revenue associated with installation is deferred based on relative sales price and recognized upon completion of the installation. Spare parts revenue is recognized when the product has been shipped and risk of loss has passed to the customer, and collectability is reasonably assured. Service and maintenance contract revenue is recognized ratably over the term of the maintenance contract. Revenue from services performed in the absence of a contract, such as consulting and training revenue, is recognized when the related services are performed, and collectability is reasonably assured. The Company's arrangements generally do not include any provisions for cancellation, termination or refunds that would significantly impact recognized revenue.

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The Company enters into revenue arrangements that may consist of multiple deliverables of its products and services where certain elements of a sales contract are not delivered and accepted in one reporting period.

In many instances, products are sold in stand-alone arrangements. Services are sold separately through renewals of annual maintenance contracts. As a result, for substantially all of the arrangements with multiple deliverables pertaining to products and services, the Company uses VSOE or TPE to allocate the selling price to each deliverable. The Company determines TPE based on historical prices charged for products and services when sold on a stand-alone basis.

When the Company is unable to establish relative selling price using VSOE or TPE, the Company uses ESP in its allocation of arrangement consideration. The objective of ESP is to determine the price at which the Company would transact a sale if the product or service were sold on a stand-alone basis. ESP could potentially be used for new or customized products.

The Company regularly reviews relative selling prices and maintains internal controls over the establishment and updates of these estimates.

Table of Contents**NOTE 2 FAIR VALUE MEASUREMENTS**

On July 1, 2009, the Company adopted the newly issued accounting standard for fair value measurements of all non-financial assets and non-financial liabilities not recognized or disclosed at fair value in the financial statements on a recurring basis. The Company's financial assets are measured and recorded at fair value, except for equity investments in privately-held companies. These equity investments are generally accounted for under the cost method of accounting and are periodically assessed for other-than-temporary impairment when an event or circumstance indicates that an other-than-temporary decline in value may have occurred. The Company's non-financial assets, such as goodwill, intangible assets, and property, plant and equipment, are recorded at cost and are assessed for impairment when an event or circumstance indicates that an other-than-temporary decline in value may have occurred.

As of March 31, 2010, the Company did not elect the fair value option that permits companies to measure eligible financial instruments at fair value for any financial assets and liabilities that were not previously measured at fair value, with the exception of the Put Option related to the auction rate securities repurchase agreement with UBS AG referenced in Note 4, Marketable Securities.

Fair Value Hierarchy. The authoritative guidance for fair value measurements establishes a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy under the guidance are described below:

- Level 1 Valuations based on unadjusted quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
- Level 2 Valuations based on unadjusted quoted prices for similar assets or liabilities, unadjusted quoted prices in markets that are not active, or other inputs that are observable or can be corroborated by observable data for substantially the full term of the assets or liabilities.
- Level 3 Valuations based on inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

A financial instrument's level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.

Most of the Company's financial instruments are classified within Level 1 or Level 2 of the fair value hierarchy because they are valued using quoted market prices, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency. The types of instruments valued based on quoted market prices in active markets include money market funds and U.S. Treasury securities. Such instruments are generally classified within Level 1 of the fair value hierarchy.

The types of instruments valued based on other observable inputs include U.S. agency securities, commercial paper, U.S. corporate bonds and municipal obligations. The market inputs used to value these instruments generally consist of market yields, reported trades and broker/dealer quotes. Such instruments are generally classified within Level 2 of the fair value hierarchy.

The principal market in which the Company executes its foreign currency contracts is the institutional market in an over-the-counter environment with a relatively high level of price transparency. The market participants usually are large commercial banks. The Company's foreign currency contracts' valuation inputs are based on quoted prices and quoted pricing intervals from public data sources and do not involve management judgment. These contracts are typically classified within Level 2 of the fair value hierarchy.

The types of instruments valued based on unobservable inputs include the auction rate securities held by the Company. Such instruments are generally classified within Level 3 of the fair value hierarchy. The Company estimated the fair value of these auction rate securities using a discounted cash flow model incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions include estimates for interest rates, timing and amount of cash flows and expected holding periods of the auction rate securities.

Financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2010 were as follows:

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(In thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
U.S. Treasuries	\$ 53,057	\$ 33,989	\$ 19,068	
U.S. Government agency securities	285,960	280,884	5,076	
Municipal bonds	57,499		57,499	
Corporate debt securities	586,427		586,427	
Money market, bank deposits and other	404,558	404,502	56	
Sovereign securities	9,383	4,138	5,245	
Auction rate securities	26,147			26,147
Total marketable securities	1,423,031	723,513	673,371	26,147

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(In thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Money market and other	2,631	2,631		
Mutual funds	115,188	115,188		
Executive deferred savings plan	117,819	117,819		
Derivative assets	4,400		2,125	2,275
Total financial assets	\$ 1,545,250	\$ 841,332	\$ 675,496	\$ 28,422
Derivative liabilities	\$ (2,267)	\$	\$ (2,267)	\$
Total financial liabilities	\$ (2,267)	\$	\$ (2,267)	\$

Assets and liabilities measured at fair value on a recurring basis were presented on the Company's Condensed Consolidated Balance Sheet as of March 31, 2010 as follows:

(In thousands)	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash equivalents	\$ 413,012	\$ 395,443	\$ 17,569	\$
Marketable securities	1,010,019	328,070	655,802	26,147
Other current assets	4,400		2,125	2,275
Other non-current assets	117,819	117,819		
Total financial assets	\$ 1,545,250	\$ 841,332	\$ 675,496	\$ 28,422
Other current liabilities	\$ (2,267)	\$	\$ (2,267)	\$
Total financial liabilities	\$ (2,267)	\$	\$ (2,267)	\$

Changes in our Level 3 securities for the three and nine months ended March 31, 2010 and 2009 were as follows:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Beginning aggregate estimated fair value of Level 3 securities	\$ 32,365	\$ 40,879	\$ 40,584	\$ 42,147
Total realized and unrealized gains				22
Unrealized gain included in other comprehensive income				(6,495)
Unrealized gain (loss) included in income	7	192	63	(6,495)
Reversal of unrealized loss associated with transfer of securities to trading securities				1,281
Net purchases (settlements)	(3,950)	(500)	(12,225)	3,616
Ending aggregate estimated fair value of Level 3 securities	\$ 28,422	\$ 40,571	\$ 28,422	\$ 40,571

Table of Contents**NOTE 3 BALANCE SHEET COMPONENTS**

(In thousands)	March 31, 2010	June 30, 2009
Accounts receivable, net		
Accounts receivable, gross	\$ 357,623	\$ 245,618
Allowance for doubtful accounts	(35,081)	(35,475)
	\$ 322,542	\$ 210,143
Inventories, net		
Service parts	\$ 135,862	\$ 146,724
Raw materials	110,637	99,383
Work-in-process	78,357	66,292
Finished goods and demonstration equipment	49,579	57,807
	\$ 374,435	\$ 370,206
Other current assets		
Prepaid expenses	\$ 36,528	\$ 61,854
Income tax related receivables	72,119	138,500
Other current assets	46,264	26,909
	\$ 154,911	\$ 227,263
Land, property and equipment, net		
Land	\$ 41,836	\$ 52,493
Buildings and improvements	122,615	132,872
Machinery and equipment	446,051	410,643
Office furniture and fixtures	24,778	23,976
Leasehold improvements	96,288	106,811
Construction in progress	7,651	1,171
	739,219	727,966
Less: accumulated depreciation and amortization	(495,461)	(436,088)
	\$ 243,758	\$ 291,878
Other non-current assets		
Long-term investments	\$ 139,118	\$ 128,776
Deferred tax assets long-term	261,648	295,536
Other	15,723	16,272
	\$ 416,489	\$ 440,584
Other current liabilities		
Warranty and retrofit obligations	\$ 19,158	\$ 21,812
Compensation and benefits	260,662	176,828
Income taxes payable	13,766	15,536
Interest payable	21,706	8,769
Accrued litigation costs	7,907	4,848
Other accrued expenses	71,820	113,648

Table of Contents**NOTE 4 MARKETABLE SECURITIES**

The amortized costs and estimated fair value of marketable securities as of March 31, 2010 and June 30, 2009 are as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
As of March 31, 2010 (In thousands)				
U.S. Treasuries	\$ 53,083	\$ 2	\$ (28)	\$ 53,057
U.S. Government agency securities	285,273	883	(196)	285,960
Municipal bonds	57,108	400	(9)	57,499
Corporate debt securities	580,911	5,816	(300)	586,427
Money market, bank deposits and other	404,558			404,558
Sovereign securities	9,320	63		9,383
Auction rate securities	28,425		(2,278)	26,147
Subtotal	1,418,678	7,164	(2,811)	1,423,031
Less: Cash equivalents	413,009	4	(1)	413,012
Marketable securities	\$ 1,005,669	\$ 7,160	\$ (2,810)	\$ 1,010,019
As of June 30, 2009 (In thousands)				
U.S. Treasuries	\$ 85,843	\$ 576	\$ (7)	\$ 86,412
U.S. Government agency securities	277,762	2,089	(155)	279,696
Municipal bonds	30,228	260	(68)	30,420
Corporate debt securities	349,522	3,478	(557)	352,443
Money market, bank deposits and other	325,014			325,014
Sovereign securities	10,319	73	(31)	10,361
Auction rate securities	40,650		(2,482)	38,168
Subtotal	1,119,338	6,476	(3,300)	1,122,514
Less: Cash equivalents	317,597			317,597
Marketable securities	\$ 801,741	\$ 6,476	\$ (3,300)	\$ 804,917

KLA-Tencor's investment portfolio consists of both corporate and government securities that have a maximum maturity of three years. The longer the duration of these securities, the more susceptible they are to changes in market interest rates and bond yields. As yields increase, those securities with a lower yield-at-cost show a mark-to-market unrealized loss. The fair value of these securities is impacted by market interest rates and credit spreads. The rise of market interest rates or credit spreads may lower the fair value of our investment portfolio. As of March 31, 2010, none of the unrealized losses of the securities are a result of other-than-temporary credit impairments. The Company believes it will realize the full value of these investments upon maturity.

The following table summarizes the fair value of its investments that had gross unrealized losses as of March 31, 2010:

(In thousands)	Fair Value	Gross Unrealized Losses(1)
U.S. Treasuries	\$ 48,695	\$ (28)

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U.S. Government agency securities	131,402	(196)
Municipal bonds	5,829	(9)
Corporate debt securities	102,617	(300)
Auction rate securities (2)	26,147	(2,278)
Total	\$ 314,690	\$ (2,811)

- (1) Of the total gross unrealized losses, there were no amounts from available-for-sale securities that have been in a loss position for 12 months or more.
- (2) The auction rate securities have been in a continuous loss position for more than 12 months and are classified as trading securities.

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The contractual maturities of securities classified as available-for-sale as of March 31, 2010, regardless of the consolidated balance sheet classification, are as follows:

(In thousands)	Amortized Cost	Estimated Fair Value
Due within one year	\$ 233,757	\$ 235,766
Due after one year through three years	743,487	748,106
	\$ 977,244	\$ 983,872

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Net realized gains for the three and nine months ended March 31, 2010 were approximately \$0.8 million and \$2.8 million, respectively.

The Company's investment portfolio includes auction rate securities, which are investments with contractual maturities generally between 20 to 30 years. They are usually found in the form of municipal bonds, preferred stock, a pool of student loans, or collateralized debt obligations whose interest rates are reset. The reset typically occurs every seven to forty-nine days, through an auction process. At the end of each reset period, investors can sell or continue to hold the securities at par. The auction rate securities held by the Company are backed by student loans and are collateralized, insured and guaranteed by the United States Federal Department of Education. In addition, all auction rate securities held by the Company are rated by the major independent rating agencies as either AAA or Aaa. In February 2008, because sell orders exceeded buy orders, auctions failed for approximately \$48.2 million in par value of municipal auction rate securities held by the Company. These failures are not believed to be a credit issue, but rather caused by a lack of liquidity. The funds associated with these failed auctions may not be accessible until the issuer calls the security, a successful auction occurs, a buyer is found outside of the auction process, or the security matures. Prior to June 30, 2009, a total of \$7.6 million of the auction rate securities held by the Company were called at par value by the issuer (therefore no losses were recognized on these securities). During the three and nine months ended March 31, 2010, an additional \$4.0 million and \$12.3 million, respectively, of the auction rate securities were called at par value by the issuer. The fair value of the auction rate securities at March 31, 2010 was \$26.1 million (par value of \$28.4 million), which is included in marketable securities under current assets.

By letter dated August 8, 2008, the Company received notification from UBS AG (UBS), in connection with a settlement entered into between UBS and certain regulatory agencies, offering to repurchase all of the Company's auction rate security holdings at par value. The Company formally accepted the settlement offer and entered into a repurchase agreement (Agreement) with UBS on November 11, 2008 (Acceptance Date). By accepting the Agreement, the Company (1) received the right (Put Option) to sell its auction rate securities at par value to UBS between June 30, 2010 and June 30, 2012 and (2) gave UBS the right to purchase the auction rate securities from the Company any time after the Acceptance Date as long as the Company receives the par value. The Company's intention is to exercise its right with UBS to sell these auction rate securities at par value at the earliest date possible, which is June 30, 2010. However, if the Put Option is not exercised before June 30, 2012, it will expire, and UBS will have no further rights or obligation to buy the auction rate securities.

The Agreement covers \$28.4 million par value (fair value of \$26.1 million) of the auction rate securities held by the Company as of March 31, 2010. The Company is accounting for the Put Option as a freestanding financial instrument and elected to record the value under the fair value option during the three months ended March 31, 2010. The fair value of the Put Option was \$2.3 million and \$2.4 million as of March 31, 2010 and June 30, 2009, respectively.

During the three months ended December 31, 2008, the Company made an election pursuant to authoritative guidance for debt and equity investments to transfer these auction rate securities from available-for-sale to trading securities. The transfer to trading securities reflects the Company's intent to exercise the Put Option during the period June 30, 2010 to June 30, 2012. During the three months ended March 31, 2010, the Company recognized an increase in the fair value of the auction rate securities of \$0.7 million, which is included in interest income and other, net. There was no change in the fair value of the auction rate securities for the nine months ended March 31, 2010.

The Company expects that the future changes in the fair value of the Put Option will continue to be largely offset by the fair value movements in the auction rate securities. The Company estimated the fair value of the auction rate securities using a discounted cash flow model incorporating assumptions that market participants would use in their estimates of fair value. Some of these assumptions include estimates for interest rates, timing and amount of cash flows and expected holding periods of the auction rate securities. The Company estimated the fair value of the Put Option using the expected value that the Company will receive from UBS, which was calculated as the difference between the anticipated recognized losses and par value of the auction rate securities as of the option exercise date. This value was discounted by using UBS's credit

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default swap rate to account for the credit considerations of the counterparty risk. The Company does not believe that the lack of liquidity of its auction rate securities will have a material impact on its overall ability to meet its cash requirements for the foreseeable future.

Table of Contents**Executive Deferred Savings Plan**

The Company maintains an Executive Deferred Savings Plan, which is a non-qualified deferred compensation plan whereby non-employee directors and certain highly compensated employees may defer a portion of their salary and bonus. Participants are credited with returns based on their allocation of their account balances among measurement funds. The Company administers the investment of these funds, and the participants remain general creditors of the Company. Distributions from the plan commence the quarter following a participant's retirement or termination of employment. The Company classifies these deferred compensation plan investments as trading securities. As of March 31, 2010, the Company had a deferred compensation plan related asset and liability of \$117.8 million and \$118.5 million included as a component of other non-current assets and other current liabilities on the Condensed Consolidated Balance Sheet, respectively. As of June 30, 2009, the Company had a deferred compensation plan related asset and liability of \$107.2 million and \$108.3 million included as a component of other non-current assets and other current liabilities on the Condensed Consolidated Balance Sheet, respectively.

NOTE 5 BUSINESS COMBINATIONS

The Company accounts for business combinations using the purchase method of accounting. Consideration includes the cash paid and the value of options assumed, if any, less any cash acquired, and excludes contingent employee compensation payable in cash.

During the three months ended March 31, 2010, the Company acquired a manufacturer of high-resolution surface metrology systems for industrial and academic uses for net cash consideration of approximately \$1.5 million, plus potential future earnout payments based upon post-closing business performance. The acquisition has been accounted for as a business combination. This acquisition has expanded the breadth of the Company's existing surface metrology product portfolio and provided enhanced value to the Company's customers by enabling them to select the optimal combination of performance and price required for their research or production needs.

During the three months ended September 30, 2008, the Company completed its acquisition of the Microelectronic Inspection Equipment business unit (MIE business unit) of Vistec Semiconductor Systems for net cash consideration of approximately \$141.4 million. The acquired MIE business unit is a provider of mask registration measurement tools, scanning electron microscopy (SEM) based tools for mask critical dimension measurement and macro defect inspection systems.

The following table represents the final purchase price allocation and summarizes the aggregate estimated fair values of the net assets acquired on the closing date of the acquisition of the MIE business unit:

(In thousands)	Final Purchase Price Allocation
Cash	\$ 14,219
Current assets	60,094
Intangibles:	
Existing technology	39,800
Patents	18,200
Trade name/Trademarks	4,800
Customer relationships	19,300
In-process R&D (IPR&D)	8,600
Backlog	6,750
Other intangible assets	9,950
Non-current assets	2,749
Goodwill	33,071
Liabilities assumed	(61,915)
 Cash consideration paid	 \$ 155,618

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired. The \$33.1 million of goodwill was assigned to the defect inspection reporting unit and is not expected to be deductible for tax purposes. This acquisition has provided the Company with a line of mask registration measurement tools to complement the Company's mask inspection products. In addition, through the acquisition the Company has acquired a provider of SEM-based tools for mask critical dimension measurement. Other

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technologies of the MIE business unit acquired by the Company in the transaction include macro defect inspection systems, overlay measurement systems for microelectromechanical systems (MEMS) applications and software packages for defect classification and data analysis.

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The results of operations of the acquired MIE business unit are included in the accompanying Condensed Consolidated Statement of Operations from the closing date of the acquisition on September 30, 2008. Pro forma earnings information has not been presented because the effect of the acquisition of the MIE business unit is not material.

The fair value of the purchased IPR&D and identified intangibles was determined using the income approach, which discounts expected future cash flows from projects to their net present value. Each project was analyzed to determine the technological innovations included; the utilization of core technology; the complexity, cost and time to complete development; any alternative future use or current technological feasibility; and the stage of completion. Future cash flows were estimated, taking into account the expected life cycles of the products and the underlying technology, relevant market sizes and industry trends. The Company determined a discount rate for each project based on the relative risks inherent in the project's development horizon, the estimated costs of development, and the level of technological change in the project and the industry, among other factors.

The Company expensed IPR&D of \$8.6 million upon the completion of the acquisition of the MIE business unit in the three months ended September 30, 2008, in connection with acquired intellectual property for which technological feasibility had not been established and no future alternative uses existed.

NOTE 6 GOODWILL AND PURCHASED INTANGIBLE ASSETS**Goodwill**

The following table presents goodwill balances and the movements during the nine months ended March 31, 2010 and 2009:

(In thousands)	Nine months ended March 31,	
	2010	2009
Gross beginning balance as of beginning of fiscal year	\$ 605,965	\$ 601,882
Accumulated impairment losses	(276,586)	
Net beginning balance as of beginning of fiscal year	329,379	601,882
Acquisitions	877	33,071
Net exchange differences	(2,079)	(47,082)
Adjustments		10,013
Impairment		(276,586)
Net ending balance as of March 31	\$ 328,177	\$ 321,298
(In thousands)	As of	As of
	March 31, 2010	March 31, 2009
Gross goodwill balance	\$ 604,763	\$ 597,884
Accumulated impairment losses	(276,586)	(276,586)
Net goodwill balance	\$ 328,177	\$ 321,298

Goodwill represents the excess of the purchase price over the fair value of the net tangible and identifiable intangible assets acquired in each business combination. The Company completed its annual evaluation of the goodwill by reporting unit during the three month period ended December 31, 2009 and concluded that there was no impairment. As of December 31, 2009, the Company's assessment of goodwill impairment indicated that the fair values of the Company's reporting units were substantially in excess of their estimated carrying values, and therefore goodwill in the reporting units was not impaired.

During the fiscal year ended June 30, 2009, the Company completed its annual evaluation of the goodwill by reporting unit as of December 31, 2008. As a result of the global economic downturn, reductions to the Company's revenue, operating income and cash flow forecasts, and a

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significant reduction in the Company's market capitalization, the Company determined that the goodwill related to its Metrology reporting unit was impaired as of December 31, 2008. As a result, the Company recorded an impairment charge of \$272.1 million, which represented the entire goodwill amount related to the Metrology reporting unit, during the three months ended December 31, 2008. The Company's assessment of goodwill impairment indicated that the fair values of the Company's other reporting units exceeded their estimated carrying values, and therefore goodwill in those reporting units was not impaired.

Fair value of a reporting unit is determined by using a weighted combination of two market-based approaches and an income approach, as this combination is deemed to be the most indicative of the Company's fair value in an orderly transaction between market participants and is consistent in principle with the methodology used for goodwill evaluation in the prior year. Under one of the market-based approaches, the Company utilizes information regarding the Company as well as publicly available industry information to determine earnings multiples and sales multiples that are used to value the Company's reporting units. The Company assigns an equal weighting to the second market-based approach—calculation of fair value of a reporting unit based on its discounted cash flow. Under the income approach, the Company determines fair value based on estimated future cash flows of each reporting

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unit, discounted by an estimated weighted-average cost of capital, which reflects the overall level of inherent risk of a reporting unit and the rate of return an outside investor would expect to earn. Determining the fair value of a reporting unit is judgmental in nature and requires the use of significant estimates and assumptions, including revenue growth rates, operating margins, discount rates and future market conditions, among others.

Purchased Intangible Assets

The components of purchased intangible assets as of March 31, 2010 and June 30, 2009 were as follows:

Category	Range of Useful Lives	As of March 31, 2010			As of June 30, 2009		
		Gross Carrying Amount	Accumulated Amortization and Impairment	Net Amount	Gross Carrying Amount	Accumulated Amortization and Impairment	Net Amount
Existing technology	4-7 years	\$ 133,066	\$ 70,707	\$ 62,359	\$ 131,966	\$ 56,367	\$ 75,599
Patents	6-13 years	57,649	32,623	25,026	57,626	27,847	29,779
Trade name / Trademark	4-10 years	19,894	10,646	9,248	19,616	9,221	10,395
Customer relationships	6-7 years	54,823	26,116	28,707	54,409	21,673	32,736
Other	0-1 year	16,199	15,685	514	16,759	16,188	571
Total		\$ 281,631	\$ 155,777	\$ 125,854	\$ 280,376	\$ 131,296	\$ 149,080

Intangible assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset or asset group may not be recoverable. During the fiscal year ended June 30, 2008, the Company identified a certain business unit as held for sale. This business unit was subsequently sold during the three months ended December 31, 2009, and the Company recognized a gain of \$0.8 million in connection with the sale.

During the quarter ended December 31, 2008, the economic conditions that affect the Company's industry deteriorated, which led our customers to scale back their production operations and reduce their capital expenditures. At that time, industry analysts expected demand for semiconductor capital equipment to continue to remain weak until macroeconomic conditions improved. In addition, the Company experienced a significant decline in its stock price, resulting in a significant reduction in the Company's market capitalization. These factors were taken into account as the Company performed an assessment of its purchased intangible assets during the quarter ended December 31, 2008 to test for recoverability in accordance with the authoritative guidance on impairment of long-lived assets. The assessment of recoverability is based on management's estimates. Based on the assessment, the Company recorded an intangible asset impairment charge of \$162.8 million during the three months ended December 31, 2008, of which \$73.1 million related to existing technology, \$26.3 million to patents, \$38.1 million to customer relationships, \$16.6 million to trademarks and \$8.7 million to other intangible assets.

For the three months ended March 31, 2010 and 2009, amortization expense for purchased intangible assets was \$8.6 million and \$16.7 million, respectively. For the nine months ended March 31, 2010 and 2009, amortization expense for other intangible assets was \$25.3 million and \$57.7 million, respectively. Based on the intangible assets recorded as of March 31, 2010, and assuming no subsequent additions to or impairment of the underlying assets, the remaining estimated amortization expense is expected to be as follows:

Fiscal year ending June 30:	Amortization (in thousands)
2010 (remaining 3 months)	\$ 8,518
2011	32,705
2012	29,931
2013	20,658
2014	15,238
Thereafter	18,804

Total	\$ 125,854
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NOTE 7 LONG-TERM DEBT

In April 2008, the Company issued \$750 million aggregate principal amount of 6.90% senior, unsecured long-term debt due in 2018 with an effective interest rate of 7.00%. The discount on the debt amounted to \$5.4 million and is being amortized over the life of the debt using the straight-line method as opposed to the interest method due to immateriality. Interest is payable semi-annually on November 1 and May 1. The debt indenture includes covenants that limit the Company's ability to grant liens on its facilities and to enter into sale and leaseback transactions, subject to significant allowances under which certain sale and leaseback transactions are not restricted. The Company was in compliance with all of its covenants as of March 31, 2010.

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In certain circumstances involving a change of control followed by a downgrade of the rating of the Company's senior notes, the Company will be required to make an offer to repurchase the senior notes at a purchase price equal to 101% of the aggregate principal amount of the notes repurchased, plus accrued and unpaid interest. The Company's ability to repurchase the senior notes in such event may be limited by law, by the indenture associated with the senior notes, or by the terms of other agreements to which the Company may be party at such time. If the Company fails to repurchase the senior notes as required by the indenture, it would constitute an event of default under the indenture governing the senior notes which, in turn, may also constitute an event of default under other of the Company's obligations.

Based on the trading prices of the debt as of March 31, 2010 and June 30, 2009, the estimated fair value of the debt was \$794.6 million and \$702.0 million, respectively.

NOTE 8 STOCK-BASED COMPENSATION**Equity Incentive Program**

Under the Company's current equity incentive program, the Company issues equity awards from its 2004 Equity Incentive Plan (the 2004 Plan), which provides for the grant of options to purchase shares of its common stock, stock appreciation rights, restricted stock units, performance shares, performance units and deferred stock units to its employees, consultants and members of its Board of Directors. The 2004 Plan was approved by the Company's stockholders on October 18, 2004 and permits the issuance of up to 32.0 million shares of common stock, including 11.0 million shares approved by the Company's stockholders on November 4, 2009. As of March 31, 2010, 13.5 million shares were available for grant under the 2004 Plan. Any 2004 Plan awards of restricted stock units, performance shares, performance units or deferred stock units with a per share or unit purchase price lower than 100% of fair market value on the grant date are counted against the total number of shares issuable under the 2004 Plan as 1.8 shares for every one share subject thereto. During the nine months ended March 31, 2010, approximately 0.3 million restricted stock units were granted to senior management with performance-based and service-based vesting criteria.

The following table summarizes the combined activity under the Company's equity incentive plans for the indicated period:

(In thousands)	Available For Grant
Balances at June 30, 2009(1)	7,702
Shares added to 2004 Plan	11,000
Restricted stock units granted(2)	(5,184)
Restricted stock units canceled(2)	1,075
Restricted stock units traded for taxes(3)	244
Options canceled/expired/forfeited	1,046
Plan shares expired(4)	(784)
 Balances at March 31, 2010(1)	 15,099

- (1) Includes shares available for issuance under the 2004 Plan, as well as under the Company's 1998 Outside Director Option Plan (the Outside Director Plan), which only permits the issuance of stock options to the Company's non-employee directors. As of March 31, 2010, approximately 1.6 million shares were available for grant under the Outside Director Plan.
- (2) Any 2004 Plan awards of restricted stock units, performance shares, performance units or deferred stock units with a per share or unit purchase price lower than 100% of fair market value on the grant date are counted against the total number of shares issuable under the 2004 Plan as 1.8 shares for every one share subject thereto.
- (3) Effective November 4, 2009, any shares withheld by the Company after such date in satisfaction of applicable withholding taxes upon the issuance, vesting or settlement of equity awards under the 2004 Plan will no longer be available for future issuance under the 2004 Plan.
- (4) Represents the portion of shares listed as Options canceled/expired/forfeited above that were issued under the Company's equity incentive plans other than the 2004 Plan or the Outside Director Plan. Because the Company is only currently authorized to issue equity awards under the 2004 Plan and the Outside Director Plan, any equity awards that are canceled, expire or are forfeited under any other Company equity incentive plan do not result in additional shares being available to the Company for future grant.

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Except for options granted to non-employee directors as part of their regular compensation package for service through the end of the first quarter of fiscal year 2008, the Company has granted only restricted stock units under its equity incentive program since September 2006. For the preceding several years until June 30, 2006, stock options were generally granted at the market price of the Company's common stock on the date of grant (except for the retroactively priced options which were granted primarily prior to the fiscal year ended June 30, 2002), with a vesting period of five years and an exercise period not to exceed seven years (ten years for options granted prior to July 1, 2005) from the date of issuance. Restricted stock units may be granted with varying criteria such as service-based and/or performance-based vesting.

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The fair value of stock-based awards is measured at the grant date and is recognized as expense over the employee's requisite service period. The fair value is determined using a Black-Scholes valuation model for stock options and for purchase rights under the Company's Employee Stock Purchase Plan and using the closing price of the Company's common stock on the grant date for restricted stock units.

The following table shows pre-tax stock-based compensation expense for the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Stock-based compensation expense:				
Costs of revenues	\$ 3,793	\$ 4,706	\$ 10,406	\$ 14,841
Engineering, research and development	6,843	7,524	20,113	24,477
Selling, general and administrative	10,833	10,528	32,004	40,125
Total stock-based compensation expense	\$ 21,469	\$ 22,758	\$ 62,523	\$ 79,443

Stock Options

The following table summarizes the activities and weighted-average exercise price for stock options under all plans during the nine months ended March 31, 2010:

Stock Options	Shares (In thousands)	Weighted-Average Exercise Price
Outstanding stock options as of June 30, 2009	12,979	\$ 43.49
Granted		\$
Exercised	(452)	\$ 33.01
Cancelled/expired/forfeited	(1,046)	\$ 45.04
Outstanding stock options as of March 31, 2010	11,481	\$ 43.76
Vested and exercisable as of March 31, 2010	11,088	\$ 43.66

The Company has not issued any stock options since November 1, 2007. The weighted-average remaining contractual terms for total options outstanding under all plans and for total options exercisable under all plans were 3.0 years and 3.0 years, respectively. The aggregate intrinsic value for the options exercisable as of March 31, 2010 was \$1.9 million.

The authoritative guidance on stock-based compensation permits companies to select the option-pricing model used to estimate the fair value of their stock-based compensation awards. The Black-Scholes option-pricing model requires the input of highly subjective assumptions, including the option's expected life and the price volatility of the underlying stock. The expected stock price volatility assumption was based on market-based implied volatility from traded options on the Company's stock.

The following table shows the total intrinsic value of options exercised, total cash received from employees as a result of employee stock option exercises, and tax benefits realized by the Company in connection with these stock option exercises for the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended March 31,	Nine months ended March 31,
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	2010	2009	2010	2009
Total intrinsic value of options exercised	\$ 60	\$	\$ 1,165	\$ 10,631
Total cash received from employees as a result of employee stock option exercises	\$ 351	\$	\$ 14,929	\$ 9,585
Tax benefits realized by the Company in connection with these exercises	\$ 23	\$	\$ 429	\$ 4,014

As of March 31, 2010, the unrecognized stock-based compensation balance related to stock options was \$5.5 million and will be recognized over an estimated weighted-average amortization period of 0.7 years.

The Company settles employee stock option exercises with newly issued common shares except in certain tax jurisdictions where settling such exercises with treasury shares provides the Company or one of its subsidiaries with a tax benefit.

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The following table shows the amount of stock-based compensation that was capitalized as inventory as of March 31, 2010 and June 30, 2009:

(In thousands)	March 31, 2010	June 30, 2009
Inventory	\$ 6,519	\$ 6,561

Restricted Stock Units

The following table shows the applicable number of restricted stock units and weighted-average grant date fair value for restricted stock units granted, vested and released, traded for taxes, and forfeited during the nine months ended March 31, 2010 and restricted stock units outstanding as of March 31, 2010 and June 30, 2009:

Restricted Stock Units	Shares (In thousands) (1)	Weighted-Average Grant Date Fair Value
Outstanding restricted stock units as of June 30, 2009	5,464	\$ 24.77
Granted	2,880	\$ 22.18
Vested and released	(806)	\$ 29.64
Traded for taxes	(395)	\$ 30.91
Forfeited	(597)	\$ 25.21
Outstanding restricted stock units as of March 31, 2010	6,546	\$ 22.62

- (1) Share numbers reflect actual shares subject to awarded restricted stock units. Under the terms of the 2004 Plan, each of the share numbers presented in this column are multiplied by 1.8 to calculate their impact on the share reserve under the 2004 Plan.

The restricted stock units granted by the Company since the beginning of the fiscal year ended June 30, 2007 generally vest in two equal installments on the second and fourth anniversaries of the date of grant. Prior to the fiscal year ended June 30, 2007, the restricted stock units granted by the Company generally vested in two equal installments over four or five years from the anniversary date of the grant. The value of the restricted stock units is based on the closing market price of the Company's common stock on the date of award. The restricted stock units have been awarded under the Company's 2004 Plan, and each unit will entitle the recipient to one share of common stock when the applicable vesting requirements for that unit are satisfied. However, for each share actually issued under the awarded restricted stock units, the share reserve under the 2004 Plan will be reduced by 1.8 shares, as provided under the terms of the 2004 Plan.

As of March 31, 2010, the unrecognized stock-based compensation balance related to restricted stock units was \$112.2 million and will be recognized over an estimated weighted-average amortization period of 2.5 years.

In connection with the vested and released restricted stock units, the Company realized tax benefits as follows during the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Tax benefits realized in connection with vested and released restricted stock units	\$ 776	\$ 500	\$ 13,931	\$ 12,967

Employee Stock Purchase Plan

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KLA-Tencor's Employee Stock Purchase Plan (ESPP) provides that eligible employees may contribute up to 10% of their eligible earnings toward the semi-annual purchase of KLA-Tencor's common stock. The ESPP is qualified under Section 423 of the Internal Revenue Code. The employee's purchase price is derived from a formula based on the fair market value of the common stock at the time of enrollment into the offering period versus the fair market value on the date of purchase.

During the quarter ended December 31, 2008, the Company's Board of Directors, as part of the Company's ongoing efforts to reduce operating expenses, approved amendments to the ESPP so as to, among other things, reduce each offering period under the ESPP (and therefore the length of the look-back period) from 24 months to 6 months. This change became effective January 1, 2009, such that the offering period that began on January 1, 2009 had a duration of six months, and the purchase price with respect to such offering period was 85% of the lesser of (i) the fair market value of the Company's common stock at the commencement of the six-month offering period or (ii) the fair market value of the Company's common stock on the purchase date.

During the quarter ended March 31, 2009, the Company's Board of Directors approved further amendments to the ESPP in continuation of the Company's cost reduction efforts. Those amendments to the ESPP (a) eliminated the look-back feature (i.e., the

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reference to the fair market value of the Company's common stock at the commencement of the applicable six-month offering period) and (b) reduced the purchase price discount from 15% to 5%. These changes were effective July 1, 2009, such that the purchase price with respect to the six-month offering period that began on July 1, 2009 was 95% of the fair market value of the Company's common stock on the December 31, 2009 purchase date.

During the quarter ended December 31, 2009, in response to improvements in the business conditions within the industries that the Company serves, the Company's Board of Directors approved amendments to the ESPP that (a) reinstated the six-month look-back feature and (b) increased the purchase price discount from 5% to 15%. These changes became effective January 1, 2010, such that the purchase price with respect to each offering period beginning on or after such date will be 85% of the lesser of (i) the fair market value of the Company's common stock at the commencement of the applicable six-month offering period or (ii) the fair market value of the Company's common stock on the purchase date.

The Company estimated the fair value of purchase rights under the ESPP using a Black-Scholes valuation model. The fair value of each purchase right under the ESPP was estimated on the date of grant using the Black-Scholes option valuation model and the straight-line attribution approach with the following weighted-average assumptions:

	Three months ended		Nine months ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Stock purchase plan:				
Expected stock price volatility	35%	(*)	35%	41%
Risk-free interest rate	0.21%	(*)	0.21%	1.8%
Dividend yield	1.63%	(*)	1.63%	1.4%
Term in years	0.5	(*)	0.5	1.3

* There were no new valuations recorded during the three months ended March 31, 2009.

No compensation cost was recognized with respect to the ESPP for the six months ended December 31, 2009, as the purchase price for the ESPP offering period that ended on December 31, 2009 was based solely on the market price of the shares at the December 31, 2009 purchase date and the discount on the purchase price was 5%. As a result, no valuations were recorded during the six months ended December 31, 2009, and therefore the assumptions set forth in the table above for the three and nine months ended March 31, 2010 were identical.

The ESPP shares are replenished annually on the first day of each fiscal year by virtue of an evergreen provision. The provision allows for share replenishment equal to the lesser of 2.0 million shares or the number of shares which KLA-Tencor estimates will be required to issue under the ESPP during the forthcoming fiscal year. During the fiscal year ended June 30, 2009, a total of 2.0 million additional shares were reserved under the ESPP, and an additional 2.0 million shares have been reserved under the ESPP with respect to the fiscal year ending June 30, 2010. As of March 31, 2010 (taking into account the shares that have been added to the ESPP with respect to the fiscal year ending June 30, 2010), a total of 3.1 million shares were reserved and available for issuance under the ESPP.

In connection with the disqualifying dispositions of shares purchased under the ESPP, the Company realized tax benefits as follows during the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended		Nine months ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Tax benefits realized in connection with disqualifying dispositions of ESPP shares	\$ 65	\$ 294	\$ 932	\$ 590

Executive Severance and Consulting Agreement

During August 2008, the Company announced that effective January 1, 2009, John H. Kispert, the Company's former President and Chief Operating Officer, would cease to be an employee of the Company. In accordance with the terms of a Severance and Consulting Agreement entered into between the Company and Mr. Kispert dated August 28, 2008, Mr. Kispert received, in addition to certain cash payments and benefits, the following benefits related to his outstanding equity awards: (i) accelerated, pro-rated vesting of the unvested portion (as of the date that his employment with the Company terminated) of all of his outstanding restricted stock units, such that a percentage of the unvested portion of each such restricted stock unit grant, representing the portion of the entire service vesting period under such grant that had been served by Mr. Kispert as of the date that he ceased to be an employee of the Company, was accelerated; (ii) the acceleration of the delivery of all restricted stock units for which vesting was accelerated in accordance with the provisions of the Severance and Consulting Agreement; and (iii) the extension of the post-termination exercise period of each of Mr. Kispert's stock options so that each such option remained exercisable for twelve months following the date Mr. Kispert ceased to be an employee of the Company, but in no event beyond the original term of the award. In connection with the stock-related benefits

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agreed to under such agreement, the Company recorded an additional non-cash, stock-based compensation charge of approximately \$4.7 million during the three months ended September 30, 2008, which is included as a component of selling, general and administrative (SG&A) expense.

NOTE 9 STOCK REPURCHASE PROGRAM

Since July 1997, the Board of Directors has authorized the Company to systematically repurchase in the open market up to 62.8 million shares of its common stock under a repurchase program. This program was put into place to reduce the dilution from KLA-Tencor's equity incentive plans and employee stock purchase plan, and to return excess cash to the Company's shareholders. Subject to market conditions, applicable legal requirements and other factors, the repurchases will be made from time to time in the open market in compliance with applicable securities laws, including the Securities Exchange Act of 1934 and the rules promulgated thereunder such as Rule 10b-18. In October 2008, the Company suspended its stock repurchase program, and the Company subsequently restarted the program in February 2010. At March 31, 2010, 7.8 million shares were available for repurchase under the Company's repurchase program.

Share repurchases for the three and nine months ended March 31, 2010 and 2009 were as follows:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Number of shares of common stock repurchased	1,990		1,990	6,410
Total cost of repurchases	\$ 59,257		\$ 59,257	\$ 218,698

At March 31, 2010, \$4.6 million of the above total cost of repurchases for the three months ended March 31, 2010 was unpaid and recorded in other current liabilities. During the three months ended September 30, 2008, the Company settled purchases amounting to \$7.8 million related to transactions that had occurred during the period ended June 30, 2008.

NOTE 10 NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is calculated by dividing net income (loss) available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by using the weighted-average number of common shares outstanding during the period, increased to include the number of additional shares of common stock that would have been outstanding if the shares of common stock underlying the Company's outstanding dilutive stock options and restricted stock units had been issued. The dilutive effect of outstanding options and restricted stock units is reflected in diluted earnings per share by application of the treasury stock method. Under the treasury stock method, the amount the employee must pay for exercising stock options, the amount of compensation cost for future service that the Company has not yet recognized, and the amount of tax benefits that would be recorded in additional paid-in capital when the award becomes deductible are assumed to be used to repurchase shares. The following table sets forth the computation of basic and diluted net income (loss) per share:

(In thousands, except per share amounts)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Numerator:				
Net income (loss)	\$ 57,016	\$ (82,827)	\$ 99,215	\$ (497,792)
Denominator:				
Weighted average shares outstanding(1)	171,506	169,934	171,202	170,349
Effect of dilutive options and restricted stock units	1,851		2,230	
Denominator for diluted income (loss) per share	173,357	169,934	173,432	170,349
Basic net income (loss) per share	\$ 0.33	\$ (0.49)	\$ 0.58	\$ (2.92)
Diluted net income (loss) per share	\$ 0.33	\$ (0.49)	\$ 0.57	\$ (2.92)
Potentially dilutive securities(2)	11,510	19,405	11,311	19,405

- (1) Outstanding shares do not include unvested restricted stock units.
- (2) The potentially dilutive securities are excluded from the computation of diluted net income (loss) per share for the above periods because their effect would have been anti-dilutive.

The total amount of dividends paid during the three months ended March 31, 2010 and 2009 was \$25.7 million and \$25.5 million, respectively. The total amount of dividends paid during the nine months ended March 31, 2010 and 2009 was \$77.0 million and \$76.7 million, respectively.

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The components of comprehensive income (loss), net of tax, are as follows:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Net income (loss)	\$ 57,016	\$ (82,827)	\$ 99,215	\$ (497,792)
Other comprehensive income (loss):				
Currency translation adjustments	(1,870)	(35,348)	1,691	(116,905)
Gain on cash flow hedging instruments, net	4	4,571	724	3,069
Change in unrecognized losses and transition obligation related to pension and post-retirement plans	20	1,312	56	1,541
Unrealized gain (loss) on investments	681	(175)	606	3,222
Other comprehensive income (loss)	(1,165)	(29,640)	3,077	(109,073)
Total comprehensive income (loss)	\$ 55,851	\$ (112,467)	\$ 102,292	\$ (606,865)

NOTE 12 INCOME TAXES

The following table provides details of income taxes:

(Dollar amounts in thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Income (loss) before income taxes	\$ 80,271	\$ (77,167)	\$ 141,079	\$ (556,155)
Provision for (benefit from) taxes	23,255	5,660	41,864	(58,363)
Effective tax rate	29.0%	(7.3%)	29.7%	10.5%

Tax expense was positively impacted during the three months and nine months ended March 31, 2010 by a non-taxable increase in the assets held within the Company's Executive Deferred Savings Plan and a reduction of the gross unrecognized tax benefits from a lapsing of the statute of limitations based on authoritative tax guidance.

Tax expense was negatively impacted during the three months and nine months ended March 31, 2010 due to shortfalls from employee stock activity and the tax effect of inter-company dividends.

Windfall tax benefits arise when a company's tax deduction for employee stock activity exceeds book compensation for the same activity. A shortfall arises when the tax deduction is less than book compensation. Windfalls are recorded as increases to capital in excess of par value. Shortfalls are recorded as decreases to capital in excess of par value to the extent that cumulative windfalls exceed cumulative shortfalls. Shortfalls in excess of cumulative windfalls are recorded as provision for income taxes.

Tax expense was negatively impacted during the three months ended March 31, 2009 by the adoption of California budget legislation, signed on February 20, 2009, which will allow a taxpayer to elect an alternative method to attribute taxable income to California for tax years beginning on or after January 1, 2011. The enactment of this legislation resulted in an expense to reduce non-current deferred tax assets.

Tax expense was negatively impacted during the nine months ended March 31, 2009 by the adoption of the California budget legislation described in the preceding paragraph, as well as a goodwill impairment charge related to certain business units recorded during the nine months ended March 31, 2009, which was non-deductible for tax purposes.

In the normal course of business, the Company is subject to examination by taxing authorities throughout the world. The Company has been notified of a pending United States federal income tax examination for the fiscal years ended June 30, 2007 through June 30, 2009, which represents all completed years for which the statute of limitation has not expired. The Company is subject to state income tax examinations for

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all years beginning from the fiscal year ended June 30, 2005. The Company is also subject to examinations in major foreign jurisdictions, including Japan, Israel and Singapore, for all years beginning from the fiscal year ended June 30, 2004 and is currently under tax examinations in various other foreign tax jurisdictions. It is possible that certain examinations may be concluded in the next twelve months. The Company believes it is possible that it may recognize up to \$9.6 million of its existing unrecognized tax benefits within the next twelve months as a result of the lapse of statutes of limitations and the resolution of agreements with various foreign tax authorities.

NOTE 13 LITIGATION AND OTHER LEGAL MATTERS

Government Inquiries and SEC Settlement Relating to Historical Stock Option Practices. On May 23, 2006, the Company received a subpoena from the United States Attorney's Office (USAO) requesting information relating to the Company's past stock option grants and related accounting matters. Also on May 23, 2006, the Company received a letter from the SEC making an informal

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inquiry and request for information on the same subject matters. The Company learned on February 2, 2007 that the SEC had opened a formal investigation into these matters. The Company cooperated fully with the SEC investigation. On July 25, 2007, the Company announced that it had reached a settlement with the SEC by consenting to the entry of a permanent injunction against future violations of the reporting, books and records, and internal controls provisions of the federal securities laws. The settlement resolves completely the SEC investigation into the Company's historical stock option granting practices. KLA-Tencor was not charged by the SEC with fraud, nor was the Company required to pay any civil penalty, fine or money damages as part of the settlement. On July 31, 2008, the USAO informed the Company that it had closed its investigation and had determined not to take any action against the Company. Both the SEC and USAO investigations with respect to the Company are now closed.

The Company has also responded to inquiries from the U.S. Department of Labor (DOL), which conducted an examination of the Company's 401(k) Savings Plan prompted by the Company's stock option issues. The Company cooperated fully with this examination, and the DOL has advised the Company that it has closed its examination with no further action, subject to confirmation of resolution of any potential claims on behalf of the Company's 401(k) Savings Plan in connection with its investments in the Company's stock. The Company believes there is no basis for any such claims; however, an independent fiduciary appointed to act in the best interests of the Company's 401(k) Savings Plan has elected to participate in the previously announced settlement of the shareholder class action of all potential non-ERISA claims (described below), which will involve no additional cost to the Company, and the Company has entered into a separate settlement with the independent fiduciary of any and all potential ERISA claims, in which the Company denied all liability and paid the Company's 401(k) Savings Plan a total of \$25,000. As a result, the DOL examination has been concluded without any material adverse consequence to the Company. In addition, the Internal Revenue Service conducted an audit covering calendar year 2006 related to the Company's historical stock option practices, which was concluded in July 2008 with a payment by the Company of \$0.1 million. There can be no assurance that other inquiries, investigations or actions will not be started by other United States federal or state regulatory agencies or by foreign governmental agencies.

Shareholder Derivative Litigation Relating to Historical Stock Option Practices. Beginning on May 22, 2006, several persons and entities identifying themselves as shareholders of KLA-Tencor filed derivative actions purporting to assert claims on behalf of and in the name of the Company against several of the Company's current and former directors and officers relating to its accounting for stock options issued from 1994 to the present. The complaints in these actions allege that the individual defendants breached their fiduciary duties and other obligations to the Company and violated state and federal securities laws in connection with the Company's historical stock option granting process, its accounting for past stock options, and historical sales of stock by the individual defendants. Three substantially similar actions are pending, one in the U.S. District Court for the Northern District of California (the Federal Derivative Action, which consists of three separate lawsuits consolidated into one action); one in the California Superior Court for Santa Clara County; and one in the Delaware Chancery Court.

The plaintiffs in the derivative actions have asserted claims for violations of Sections 10(b) (including Rule 10b-5 thereunder), 14(a), and 20(a) of the Securities Exchange Act of 1934, unjust enrichment, breach of fiduciary duty and aiding and abetting such breach, negligence, misappropriation of information, abuse of control, gross mismanagement, waste of corporate assets, breach of contract, constructive fraud, rescission, and violations of California Corporations Code section 25402, as well as a claim for an accounting of all stock option grants made to the named defendants. KLA-Tencor is named as a nominal defendant in these actions. On behalf of KLA-Tencor, the plaintiffs seek unspecified monetary and other relief against the named defendants. The plaintiffs are James Ziolkowski, Mark Ziering, Alaska Electrical Pension Fund, Jeffrey Rabin and Benjamin Langford. The individual named defendants are current directors and officers Edward W. Barnholt, Robert T. Bond, Stephen P. Kaufman, and Richard P. Wallace; and former directors and officers H. Raymond Bingham, Robert J. Boehlke, Leo Chamberlain, Gary E. Dickerson, Richard J. Elkus, Jr., Dennis J. Fortino, Jeffrey L. Hall, John H. Kispert, Kenneth Levy, Michael E. Marks, Stuart J. Nichols, Arthur P. Schnitzer, Kenneth L. Schroeder, Jon D. Tompkins and Lida Urbanek. Current director David C. Wang and former directors Dennis J. Fortino, Michael E. Marks and Dean O. Morton were originally named as defendants in one of the derivative actions filed in the U.S. District Court for the Northern District of California (the Federal District Court), but were dropped as named defendants as of December 22, 2006 upon the filing of a consolidated complaint in the Federal Derivative Action.

The Company's Board of Directors appointed a Special Litigation Committee (SLC) composed solely of independent directors to conduct an independent investigation of the claims asserted in the derivative actions and to determine the Company's position with respect to those claims. On March 25, 2008, the SLC filed a motion to terminate the Federal Derivative Action and to approve certain settlements with Gary E. Dickerson, Kenneth Levy, Kenneth Schroeder and Jon D. Tompkins related to the claims brought against them in connection with the derivative actions. The Court denied the motion to terminate and to approve the settlements on December 12, 2008. The SLC filed an appeal and petition for writ of mandate challenging that decision to the United States Court of Appeals for the Ninth Circuit, which dismissed the appeal on May 8, 2009 and denied the petition for writ of mandate on July 10, 2009. The parties participated in mediation and settlement discussions regarding the derivative claims in the Federal Derivative Action.

On March 15, 2010, the Company entered into a Stipulation of Settlement (the Stipulation) with all parties to the Federal Derivative Action to resolve the Federal Derivative Action in its entirety, subject to approval by the Federal District Court (the Proposed Settlement). On March 25, 2010, the Federal District Court entered an order (the Preliminary Order) preliminarily approving the Proposed Settlement and scheduling a

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hearing for consideration of final approval of the Proposed Settlement on May 24, 2010.

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As set forth more fully in the Stipulation, under the Proposed Settlement, among other things, (i) the Company will receive cash payments totaling \$24 million from insurers; (ii) the Company will receive additional cash payments of approximately \$9.2 million from certain of the settling defendants; (iii) certain of the settling defendants relinquished compensation and other benefits, yielding an additional financial benefit to the Company of approximately \$9.4 million; (iv) the Company will pay attorneys' fees to plaintiffs' counsel in the amount of \$8 million in cash, in addition to \$8 million in shares of Company common stock to be issued following the Effective Date as defined in the Stipulation (with the number of shares determined by dividing \$8 million by the average daily closing price of the Company's common stock for the ten trading days immediately preceding the Effective Date as defined in the Stipulation); (v) the Federal Derivative Action will be dismissed with prejudice; (vi) the Company, settling defendants, related parties, and plaintiffs and their counsel will be released from claims related to the Federal Derivative Action and the matters that were or could have been alleged therein, and further litigation on such claims will be barred; and (vii) the Company will commit to maintain certain corporate governance enhancements, including certain previously implemented policies, procedures and guidelines relating to the Company's board of directors composition, stock option granting practices and procedures, and internal controls and procedures. As provided in the Stipulation, the Proposed Settlement will become final and effective following entry of judgment thereon by the Federal District Court, finality of that judgment, and final dismissal of the related shareholder derivative actions pending in the California Superior Court and Delaware Chancery Court. The Proposed Settlement represents a compromise of contested claims and does not contain any admission of wrongdoing or fault on the part of the Company, its board of directors or executive officers, or the other individual defendants to the action, all of whom deny all liability and claims of wrongdoing as part of the Proposed Settlement. This summary of the terms of the Stipulation is qualified entirely by reference to the copy of the Stipulation filed as Exhibit 99.1 to the Current Report on Form 8-K filed by the Company with the SEC on March 26, 2010, the content of which is incorporated by reference herein. During the three months ended March 31, 2010, the Company recorded a charge of \$1.7 million to selling, general and administrative expenses, reflecting the anticipated net amount to be paid by the Company in connection with the Proposed Settlement and the Company's settlements during such period of separate matters with Mr. Schroeder and Mr. Levy that are further described below.

The California Superior Court action was stayed by order of the court on March 18, 2010 pending consideration by the Federal District Court of the Proposed Settlement of the Federal Derivative Action. The Delaware Chancery Court action has been stayed since March 17, 2009 in deference to the Federal Derivative Action.

As part of the derivative lawsuit filed in the Delaware Chancery Court on July 21, 2006, a plaintiff claiming to be a KLA-Tencor shareholder also asserted a separate putative class action claim against the Company and certain of its current and former directors and officers alleging that shareholders incurred damage due to purported dilution of KLA-Tencor common stock resulting from historical stock option granting practices. On March 17, 2009, the Delaware Chancery Court dismissed the putative class action claim and stayed the derivative claims in the action. Plaintiff sought leave to appeal this decision, which the Chancery Court denied on April 14, 2009. Plaintiff subsequently filed a notice of appeal with the Delaware Supreme Court seeking to overturn the Chancery Court's denial of the application to appeal, which the Delaware Supreme Court denied on April 27, 2009. Plaintiff in the Delaware Chancery Court action advised the Company on March 19, 2010 that the Delaware Chancery Court action will be dismissed with prejudice upon final approval of the Proposed Settlement by the Federal District Court.

Notwithstanding the Proposed Settlement described above, if the Federal District Court does not grant final approval to the Proposed Settlement, or if the Effective Date as defined in the Stipulation does not occur, the derivative actions may continue. The Company therefore cannot predict with certainty whether these derivative actions are likely to result in any material recovery by or expense to KLA-Tencor.

Shareholder Class Action Litigation Relating to Historical Stock Option Practices. KLA-Tencor and various of its current and former directors and officers were named as defendants in putative securities class action filed on June 29, 2006 in the U.S. District Court for the Northern District of California. Two similar actions were filed later in the same court, and all three cases were consolidated into a single action. On September 26, 2008, Judge Charles Breyer of the Northern District granted final approval of a settlement resolving all class claims and dismissing with prejudice all claims brought by the consolidated action. The class action had alleged material misrepresentations in the Company's SEC filings and public statements and brought claims under Section 10(b) and Rule 10b-5 thereunder, Section 14(a), Section 20(a), and Section 20A of the Securities Exchange Act of 1934 as a result of the Company's past stock option grants and related accounting and reporting. The settlement resolved all claims against all defendants, who were KLA-Tencor, Edward W. Barnholt, H. Raymond Bingham, Robert T. Bond, Gary E. Dickerson, Richard J. Elkus, Jr., Jeffrey L. Hall, Stephen P. Kaufman, John H. Kispert, Kenneth Levy, Michael E. Marks, Stuart J. Nichols, Kenneth L. Schroeder, Jon D. Tompkins, Lida Urbaneck and Richard P. Wallace.

The Company made a payment of \$65.0 million to the settlement class as a term of the court-approved settlement during the three months ended September 30, 2008, which provides a full release of KLA-Tencor and the other named defendants in connection with the allegations raised in the lawsuit. The Company had reached an agreement in principle to resolve the action prior to December 31, 2007, and therefore an amount of \$65.0 million was accrued by a charge to selling, general and administrative expenses during the three months ended December 31, 2007.

Another plaintiff, Chris Crimi, filed a putative class action complaint in the Superior Court of the State of California for the County of Santa Clara on September 4, 2007 against the Company and certain of its current and former directors and officers. The

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plaintiff sought to represent a class consisting of persons who held KLA-Tencor common stock between September 20, 2002 and September 27, 2006, originally alleging causes of action for breach of fiduciary duty and rescission based on alleged misstatements and omissions in the Company's SEC filings concerning the Company's past stock option grants, and seeking unspecified damages based upon purported dilution of the Company's stock, injunctive relief, and rescission. The plaintiff named the Company, Edward W. Barnholt, H. Raymond Bingham, Robert T. Bond, Richard J. Elkus, Jr., Stephen P. Kaufman, Kenneth Levy, Michael E. Marks, Dean O. Morton, Kenneth L. Schroeder, Jon D. Tompkins, and Richard P. Wallace as defendants in the action. The Company filed a demurrer to the complaint, which was sustained, and then removed the case to the U.S. District Court for the Northern District of California upon plaintiff's filing an amended complaint. The Company then filed a motion to dismiss the action in the Northern District of California, which was granted in part, with the remaining claims being remanded back to the California Superior Court on September 12, 2008. The Company filed a demurrer to plaintiff's Second Amended Complaint and plaintiff responded by agreeing to dismiss the action with prejudice, bringing an end to this action.

Litigation with Former CEO Kenneth Schroeder. On April 17, 2009, Kenneth Schroeder, the Company's former Chief Executive Officer, served the Company with a lawsuit filed in the California Superior Court for Santa Clara County asserting various contract and tort claims in connection with the Company's termination of Mr. Schroeder and the cancellation of certain of his stock options and restricted stock units in October 2006. The Company filed a motion to compel arbitration of Mr. Schroeder's claims on June 15, 2009. After the Company filed the motion to compel, Mr. Schroeder stipulated to arbitration, and the California Superior Court for Santa Clara County issued an order compelling the arbitration of his claims and staying the state court action on July 27, 2009. Mr. Schroeder initiated an AAA arbitration claim against the Company on August 7, 2009. In response, the Company filed an Answer and Counterclaim on September 14, 2009. The Company alleged counterclaims against Mr. Schroeder for breach of fiduciary duty, unjust enrichment, fraudulent concealment, declaratory relief and equitable indemnification.

On March 15, 2010, the Company entered into a settlement agreement with Mr. Schroeder. Under the terms of the settlement, the Company will pay Mr. Schroeder \$16.5 million, the parties will release and dismiss their respective claims, and the Company's ongoing obligation to indemnify and advance Mr. Schroeder's costs of defending certain litigation brought against him by the SEC will be subject to express limitations. The settlement with Mr. Schroeder will become final upon the effectiveness of the Proposed Settlement of the Federal Derivative Action. The settlement with Mr. Schroeder does not alter, restrict or impair the parties' rights and obligations under the Proposed Settlement of the Federal Derivative Action. Because the effectiveness of this settlement is subject to the effectiveness of the Proposed Settlement of the Federal Derivative Action, the Company cannot predict with certainty the final outcome or estimate the likelihood or potential dollar amount of any adverse result in this litigation.

Settlement with Former CEO and Chairman of the Board Kenneth Levy. Kenneth Levy, the Company's former Chief Executive Officer and Chairman of the Board, asserted breach of contract and tort claims against the Company for approximately \$8.3 million in damages arising from the Company's alleged refusal to allow Mr. Levy to exercise certain of his stock options in 2007 and 2008. On March 15, 2010, the Company entered into a settlement agreement with Mr. Levy. Under the parties' settlement of those claims, the Company will pay Mr. Levy \$2.375 million, and the parties will exchange mutual releases. The settlement with Mr. Levy will become final upon the effectiveness of the Proposed Settlement of the Federal Derivative Action. The settlement with Mr. Levy does not alter, restrict or impair the parties' rights and obligations under the Proposed Settlement of the Federal Derivative Action. Because the effectiveness of this settlement is subject to the effectiveness of the Proposed Settlement of the Federal Derivative Action, the Company cannot predict with certainty the final outcome or estimate the likelihood or potential dollar amount of any adverse result in this matter.

Indemnification Obligations. Subject to certain limitations, the Company is obligated to indemnify its current and former directors, officers and employees in connection with the investigation of the Company's historical stock option practices and the related litigation and ongoing government inquiry. These obligations arise under the terms of the Company's certificate of incorporation, its bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify generally means that the Company is required to pay or reimburse the individuals reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. The Company is currently paying or reimbursing legal expenses being incurred in connection with these matters by a number of its current and former directors, officers and employees. It is also paying defense costs to two former officers and employees facing SEC civil actions to which the Company is not a party. Although the maximum potential amount of future payments KLA-Tencor could be required to make under these agreements is theoretically unlimited, the Company believes the fair value of this liability, to the extent estimable, is appropriately considered within the reserve it has established for currently pending legal proceedings.

Other Legal Matters. The Company is named from time to time as a party to lawsuits in the normal course of its business. Actions filed against the Company include commercial, intellectual property, customer, and labor and employment related claims, including complaints of alleged wrongful termination and potential class action lawsuits regarding alleged violations of federal and state wage and hour and other laws. Litigation, in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of legal proceedings are difficult to predict, and the costs incurred in litigation can be substantial, regardless of outcome. The Company believes the amounts provided in its financial statements are adequate in light of the probable and estimated liabilities.

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However, because such matters are subject to many uncertainties, the ultimate outcomes are not predictable and there can be no assurances that the actual amounts required to satisfy

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alleged liabilities from the matters described above will not exceed the amounts reflected in the Company's financial statements or will not have a material adverse effect on its results of operations, financial condition or cash flows.

NOTE 14 COMMITMENTS AND CONTINGENCIES

Factoring. KLA-Tencor has agreements with financial institutions to sell certain of its trade receivables and promissory notes from customers without recourse. KLA-Tencor does not believe it is at risk for any material losses as a result of these agreements. In addition, from time to time KLA-Tencor will discount without recourse Letters of Credit (LCs) received from customers in payment for goods.

The following table shows total receivables sold under factoring agreements, proceeds from sales of LCs and related discounting fees paid for the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended		Nine months ended	
	March 31, 2010	March 31, 2009	March 31, 2010	March 31, 2009
Receivables sold under factoring agreements	\$ 16,968	\$ 50,143	\$ 86,987	\$ 208,782
Proceeds from sales of LCs	\$ 13,384	\$	\$ 23,891	\$ 10,666
Discounting fees paid on sales of LCs(1)	\$ 26	\$	\$ 149	\$ 44

(1) Discounting fees were equivalent to interest expense and were recorded in interest income and other, net.

Facilities. KLA-Tencor leases certain of its facilities under arrangements that are accounted for as operating leases. The following is a schedule of the remaining estimated operating lease payments (in thousands):

Fiscal year ending June 30,	Amount
2010 (remaining 3 months)	\$ 2,474
2011	7,981
2012	5,294
2013	3,632
2014	2,564
2015 and thereafter	6,413
Total minimum lease payments	\$ 28,358

Rent expense was approximately \$2.1 million and \$2.4 million for the three months ended March 31, 2010 and 2009, respectively. Rent expense was approximately \$7.0 million and \$8.3 million for the nine months ended March 31, 2010 and 2009, respectively.

Purchase Commitments. KLA-Tencor maintains certain open inventory purchase commitments with its suppliers to ensure a smooth and continuous supply for key components. KLA-Tencor's liability under these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecast time-horizon can vary among different suppliers. The Company's open inventory purchase commitments were approximately \$199.5 million as of March 31, 2010 and are primarily due within the next 12 months. Actual expenditures will vary based upon the volume of the transactions and length of contractual service provided. In addition, the amounts paid under these arrangements may change in the event that the arrangements are renegotiated or canceled. Certain agreements provide for potential cancellation penalties.

Guarantees. KLA-Tencor typically provides standard warranty coverage on its systems for 40 hours per week for 12 months, providing labor and parts necessary to repair the systems during the warranty period. KLA-Tencor accounts for the estimated warranty cost as a charge to costs

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of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. Utilizing actual service records, KLA-Tencor calculates the average service hours and parts expense per system and applies the actual labor and overhead rates to determine the estimated warranty charge. KLA-Tencor updates these estimated charges on a quarterly basis. The actual product performance and/or field expense profiles may differ, and in those cases KLA-Tencor adjusts its warranty accruals accordingly.

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The following table provides the balances and changes in the product warranty accrual for the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Beginning balance	\$ 15,726	\$ 27,029	\$ 18,213	\$ 38,700
Accruals for warranties issued during the period	5,986	3,452	16,713	12,656
Changes in liability related to pre-existing warranties	(345)	(2,103)	(2,924)	(701)
Settlements made during the period	(4,120)	(7,247)	(14,755)	(29,524)
Ending balance	\$ 17,247	\$ 21,131	\$ 17,247	\$ 21,131

Subject to certain limitations, KLA-Tencor indemnifies its current and former officers and directors for certain events or occurrences. Although the maximum potential amount of future payments KLA-Tencor could be required to make under these agreements is theoretically unlimited, the Company believes the fair value of this liability, to the extent estimable, is appropriately considered within the reserve it has established for currently pending legal proceedings.

KLA-Tencor is a party to a variety of agreements pursuant to which it may be obligated to indemnify the other party with respect to certain matters. Typically, these obligations arise in connection with contracts and license agreements or the sale of assets, under which the Company customarily agrees to hold the other party harmless against losses arising from a breach of warranties, representations and covenants related to such matters as title to assets sold, validity of certain intellectual property rights, non-infringement of third-party rights, and certain income tax-related matters. In each of these circumstances, payment by the Company is typically subject to the other party making a claim to and cooperating with the Company pursuant to the procedures specified in the particular contract. This usually allows the Company to challenge the other party's claims or, in case of breach of intellectual property representations or covenants, to control the defense or settlement of any third-party claims brought against the other party. Further, the Company's obligations under these agreements may be limited in terms of amounts, activity (typically at the Company's option to replace or correct the products or terminate the agreement with a refund to the other party), and duration. In some instances, the Company may have recourse against third parties and/or insurance covering certain payments made by the Company.

It is not possible to predict the maximum potential amount of future payments under these or similar agreements due to the conditional nature of the Company's obligations and the unique facts and circumstances involved in each particular agreement. Historically, payments made by the Company under these agreements have not had a material effect on its business, financial condition, results of operations or cash flows.

The Company maintains guarantee arrangements of \$16.7 million in various locations to fund customs guarantees for VAT and LC needs of its subsidiaries in Europe and Asia. Approximately \$11.9 million was outstanding under these arrangements as of March 31, 2010.

NOTE 15 RESTRUCTURING CHARGES

In March 2009, the Company announced a plan to further reduce its global workforce by approximately 10%, which followed the Company's announcement in November 2008 of a global workforce reduction of approximately 15%. The Company has undertaken a number of cost reduction activities, including these workforce reductions, in an effort to lower its quarterly operating expense run rate. The program in the United States is accounted for in accordance with the authoritative guidance related to compensation for non-retirement post-employment benefits, whereas the programs in the international locations are accounted for in accordance with the authoritative guidance for contingencies. During the three months ended March 31, 2010, the Company recorded a \$1.2 million net restructuring charge, of which \$0.3 million was recorded to costs of revenues and \$0.9 million was recorded to selling, general and administrative expense. This charge represents the estimated minimum liability associated with expected termination benefits to be provided to employees after employment.

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The following table shows the activity primarily related to severance and benefits expense for the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Beginning balance	\$ 4,578	\$ 18,707	\$ 8,086	\$ 1,333
Restructuring costs	1,398	16,788	5,242	39,930
Adjustments	(202)	(222)	(887)	(1,555)
Cash payments	(5,038)	(13,024)	(11,705)	(17,459)
Ending balance	\$ 736	\$ 22,249	\$ 736	\$ 22,249

Substantially all of the remaining accrued restructuring balance related to the Company's workforce reductions is expected to be paid out by the end of calendar year 2010.

NOTE 16 DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The authoritative guidance requires companies to recognize all derivative instruments and hedging activities, including foreign currency exchange contracts, as either assets or liabilities at fair value on the balance sheet. Changes in the fair value of derivatives that do not qualify for hedge treatment, as well as the ineffective portion of any hedges, are reflected in the Condensed Consolidated Statement of Operations. In accordance with the guidance, the Company designates foreign currency forward exchange contracts as cash flow hedges of certain forecasted foreign currency denominated sales and purchase transactions.

KLA-Tencor's foreign subsidiaries operate and sell KLA-Tencor's products in various global markets. As a result, KLA-Tencor is exposed to risks relating to changes in foreign currency exchange rates. KLA-Tencor utilizes foreign currency forward exchange contracts and options to hedge against future movements in foreign exchange rates that affect certain existing and forecasted foreign currency denominated sales and purchase transactions, such as the Japanese yen, the euro and the Israeli shekel. KLA-Tencor does not use derivative financial instruments for speculative or trading purposes. The Company routinely hedges its exposures to certain foreign currencies with various financial institutions in an effort to minimize the impact of certain currency exchange rate fluctuations. These currency forward exchange contracts and options, designated as cash flow hedges, generally have maturities of less than 18 months. Cash flow hedges are evaluated for effectiveness monthly, based on changes in total fair value of the derivatives. If a financial counter-party to any of the Company's hedging arrangements experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, the Company may experience material financial losses.

For derivative instruments that are designated and qualify as cash flow hedges, the effective portion of the gain or loss on the derivative is reported as a component of accumulated other comprehensive income (loss) (OCI) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Changes in the fair value of currency forward exchange and option contracts due to changes in time value are excluded from the assessment of effectiveness. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current earnings.

For derivative instruments that are not designated as accounting hedges, gains and losses are recognized in interest income and other, net. The majority of such derivatives are foreign currency forward contracts to hedge certain foreign currency denominated assets or liabilities. The gains and losses on these derivatives are largely offset by the changes in the fair value of the assets or liabilities being hedged.

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The location and amounts of designated and non-designated derivative instruments' gains and losses in the condensed consolidated financial statements for the three and nine months ended March 31, 2010 and 2009 are as follows:

(In thousands)	Location in Financial Statements Three months ended March 31, 2010					Three months ended March 31, 2009				
	Accumulated OCI	Revenues	Costs of revenues	Interest income and other, net	Total	Accumulated OCI	Revenues	Costs of revenues	Interest income and other, net	Total
Derivatives Designated as Hedging Instruments										
Gain (loss) in accumulated OCI on derivative (effective portion)	\$ (460)				\$ (460)	\$ 3,240				\$ 3,240
Loss reclassified from accumulated OCI into income (effective portion)		\$ (215)	\$ (251)		\$ (466)	\$ (3,817)	\$ (316)			\$ (4,133)
Gain (loss) recognized in income on derivative (ineffectiveness portion and amount excluded from effectiveness testing)				\$ 33	\$ 33				\$ (205)	\$ (205)
Derivatives Not Designated as Hedging Instruments										
Gain (loss) recognized in income				\$ (3,422)	\$ (3,422)				\$ 3,658	\$ 3,658
Derivatives Designated as Hedging Instruments										
Derivatives Designated as Hedging Instruments										
Loss in accumulated OCI on derivative (effective portion)	\$ (862)				\$ (862)	\$ (5,211)				\$ (5,211)
Loss reclassified from accumulated OCI into income (effective portion)		\$ (1,797)	\$ (227)		\$ (2,024)	\$ (9,784)	\$ (377)			\$ (10,161)
Gain (loss) recognized in income on derivative (ineffectiveness portion and amount excluded from effectiveness testing)				\$ (286)	\$ (286)				\$ (611)	\$ (611)

**Derivatives Not Designated as
Hedging Instruments**

Loss recognized in income	\$ (5,534)	\$ (5,534)	\$ (35,648)	\$ (35,648)
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The Company's outstanding hedge contracts, with maximum maturity of 18 months, were as follows:

(In thousands)	As of March 31, 2010	As of June 30, 2009
Cash flow hedge contracts		
Purchase	\$ 10,384	\$
Sell	(32,434)	(36,938)
Other foreign currency hedge contracts		
Purchase	102,481	73,914
Sell	(56,447)	(106,080)
Net	\$ 23,984	\$ (69,104)

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The location and fair value amounts of the Company's derivative instruments reported in its Condensed Consolidated Balance Sheets as of March 31, 2010 and June 30, 2009 were as follows:

(In thousands)	Balance Sheet Location	Asset Derivatives		Balance Sheet Location	Liability Derivatives	
		March 31, 2010 Fair Value	June 30, 2009 Fair Value		March 31, 2010 Fair Value	June 30, 2009 Fair Value
Derivatives Designated as Hedging Instruments						
Foreign exchange contracts	Other current assets	\$ 704	\$ 441	Other current liabilities	\$ 862	\$ 657
Total Derivatives Designated as Hedging Instruments		\$ 704	\$ 441		\$ 862	\$ 657
Derivatives Not Designated as Hedging Instruments						
Foreign exchange contracts	Other current assets	\$ 1,421	\$ 1,803	Other current liabilities	\$ 1,405	\$ 2,142
Other(1)	Other current assets	2,275	2,416			
Total Derivatives Not Designated as Hedging Instruments		\$ 3,696	\$ 4,219		\$ 1,405	\$ 2,142
Total Derivatives		\$ 4,400	\$ 4,660		\$ 2,267	\$ 2,799

(1) Includes the Put Option to sell the Company's auction rate securities at par value to UBS.

The following table provides the balances and changes in the accumulated OCI related to derivative instruments for the three and nine months ended March 31, 2010 and 2009:

(In thousands)	Three months ended March 31,		Nine months ended March 31,	
	2010	2009	2010	2009
Beginning balance	\$ (457)	\$ (9,201)	\$ (1,613)	\$ (6,779)
Amount reclassified to income	466	4,133	2,024	10,161
Net change	(460)	3,240	(862)	(5,211)
Ending balance	\$ (451)	\$ (1,828)	\$ (451)	\$ (1,828)

NOTE 17 IMPAIRMENT OF REAL ESTATE ASSETS

During fiscal year 2009, as part of its long-term business plan, the Company decided to sell certain of its owned real estate properties located in San Jose, California. The real estate properties are non-financial assets classified within Level 3 of the fair value hierarchy. During the three months ended March 31, 2010, no additional asset impairment charge was recorded. During the nine months ended March 31, 2010, the Company recorded an asset impairment charge of approximately \$10.4 million based on the valuation of these assets using relevant market indicators such as range of estimated selling prices. This impairment charge was included in selling, general and administrative expenses.

NOTE 18 RELATED PARTY TRANSACTIONS

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During the three and nine months ended March 31, 2010 and 2009, the Company purchased from, or sold to, several entities where one or more members of the Company's Board of Directors, or their immediate family members, also serves as an executive officer or board member, including JDS Uniphase Corporation, Freescale Semiconductor, Inc. and National Semiconductor Corp. The following table provides the transactions with these parties (for the portion of such period that they were considered related):

(In thousands)	Three months ended		Nine months ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Total revenues	\$ 2,310	\$ 2,232	\$ 6,247	\$ 6,691
Total purchases	\$ 104	\$ 31	2,496	\$ 764

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The Company had a receivable balance from these parties of approximately \$2 million and \$1 million at March 31, 2010 and June 30, 2009, respectively. Management believes that such transactions are at arms length and on similar terms as would have been obtained from unaffiliated third parties.

NOTE 19 SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

KLA-Tencor reports one reportable segment in accordance with the provisions of the authoritative guidance for segment reporting. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker in deciding how to allocate resources and in assessing performance. KLA-Tencor's chief operating decision maker is the Chief Executive Officer.

KLA-Tencor is engaged primarily in designing, manufacturing, and marketing process control and yield management solutions for the semiconductor and related nanoelectronics industries. All operating units have been aggregated due to their inter-dependencies, commonality of long-term economic characteristics, products and services, the production processes, class of customer and distribution processes. The Company's service products are an extension of the system product portfolio and provide customers with spare parts and fab management services (including system preventive maintenance and optimization services) to improve yield, increase production uptime and throughput, and lower the cost of ownership. Since KLA-Tencor operates in one segment, all financial segment information can be found in the condensed consolidated financial statements.

KLA-Tencor's significant operations outside the United States include manufacturing facilities in Israel and Singapore, and sales, marketing and service offices in Western Europe, Japan and the Asia Pacific region. For geographical revenue reporting, revenues are attributed to the geographic location in which the customer is located. Long-lived assets consist primarily of net property and equipment and are attributed to the geographic region in which they are located.

The following is a summary of revenues by geographic region for the three and nine months ended March 31, 2010 and 2009:

(Dollar amounts in thousands)	Three months ended March 31,				Nine months ended March 31,			
	2010		2009		2010		2009	
Revenues:								
United States	\$ 102,156	21%	\$ 127,999	41%	\$ 282,202	23%	\$ 287,324	23%
Taiwan	176,329	37%	18,664	6%	470,395	37%	140,803	11%
Japan	51,313	11%	76,032	25%	166,806	13%	363,830	30%
Europe & Israel	28,886	6%	29,148	9%	79,719	6%	126,235	10%
Korea	49,252	10%	37,837	12%	98,201	8%	170,449	14%
Rest of Asia Pacific	70,363	15%	19,932	7%	164,018	13%	150,073	12%
Total	\$ 478,299	100%	\$ 309,612	100%	\$ 1,261,341	100%	\$ 1,238,714	100%

Long-lived assets by geographic region as of March 31, 2010 and June 30, 2009 were as follows:

(In thousands)	March 31, 2010	June 30, 2009
Long-lived assets:		
United States	\$ 215,575	\$ 239,863
Taiwan	839	1,021
Japan	3,976	4,308
Europe & Israel	103,195	143,410
Korea	3,578	3,764
Rest of Asia Pacific	58,172	64,868

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Total	\$ 385,335	\$ 457,234
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The following is a summary of revenues by major products for the three and nine months ended March 31, 2010 and 2009 (as a percentage of total revenue):

(Dollar amounts in thousands)	Three months ended March 31,				Nine months ended March 31,			
	2010		2009		2010		2009	
Revenues:								
Defect inspection	\$ 256,863	54%	\$ 158,998	51%	\$ 688,977	55%	\$ 659,594	53%
Metrology	77,370	16%	41,922	14%	177,242	14%	192,555	15%
Service	126,879	27%	98,699	32%	363,249	29%	340,673	28%
Other	17,187	3%	9,993	3%	31,873	2%	45,892	4%
Total	\$ 478,299	100%	\$ 309,612	100%	\$ 1,261,341	100%	\$ 1,238,714	100%

For the three and nine months ended March 31, 2010, two customers accounted for greater than 10% of revenues. For the three months ended March 31, 2009, one customer accounted for greater than 10% of revenue. For the nine months ended March 31, 2009, two customers accounted for greater than 10% of revenue. As of March 31, 2010, three customers accounted for greater than 10% of net accounts receivable, and as of June 30, 2009, two customers accounted for greater than 10% of net accounts receivable.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements other than statements of historical fact may be forward-looking statements. You can identify these and other forward-looking statements by the use of words such as may, will, could, would, should, expects, plans, anticipates, relies, believes, estimates, predicts, intends, potential, continue, thinks, seeks, or the negative of such terms, or other comparable terminology. Forward-looking statements also include the assumptions underlying or relating to any of the foregoing statements. Such forward-looking statements include, among others, forecasts of the future results of our operations; the percentage of spending that our customers allocate to process control; orders for our products and capital equipment generally; sales of semiconductors; the allocation of capital spending by our customers; growth of revenue in the semiconductor industry, the semiconductor capital equipment industry and our business; technological trends in the semiconductor industry; future developments or trends in the global capital and financial markets; the availability of the offer to repurchase our auction rate securities by the securities firm from which we purchased such securities; the future impact of the restatement of our historical financial statements, shareholder litigation and related matters arising from the discovery that we had retroactively priced stock options (primarily from July 1, 1997 to June 30, 2002) and had not accounted for them correctly; our future product offerings and product features; the success and market acceptance of new products; timing of shipment of backlog; the future of our product shipments and our product and service revenues; our future gross margins; our future research and development expenses and selling, general and administrative expenses; our ability to successfully implement our efforts to reduce our operating costs, and the anticipated cost savings to be realized from such efforts; international sales and operations; our ability to maintain or improve our existing competitive position; success of our product offerings; creation and funding of programs for research and development; attraction and retention of employees; results of our investment in leading edge technologies; the effects of hedging transactions; the effect of the sale of trade receivables and promissory notes from customers; our future income tax rate; dividends; the completion of any acquisitions of third parties, or the technology or assets thereof; benefits received from any acquisitions and development of acquired technologies; sufficiency of our existing cash balance, investments and cash generated from operations to meet our operating and working capital requirements; and the adoption of new accounting pronouncements.

Our actual results may differ significantly from those projected in the forward-looking statements in this report. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in Part II, Item 1A, Risk Factors in this report as well as in Item 1, Business and Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended June 30, 2009, filed with the Securities and Exchange Commission on August 7, 2009. You should carefully review these risks and also review the risks described in other documents we file from time to time with the Securities and Exchange Commission. You are cautioned not to place undue reliance on these forward-looking statements, and we expressly assume no obligation to update the forward-looking statements in this report after the date hereof.

CRITICAL ACCOUNTING ESTIMATES AND POLICIES

The preparation of our condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions in applying our accounting policies that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. Note 1 to the consolidated financial statements in our Annual Report on Form 10-K for the fiscal year ended June 30, 2009 describes the significant accounting policies and methods used in preparation of our consolidated financial statements. We based these estimates and assumptions on historical experience and evaluate them on an on-going basis to ensure that they remain reasonable under current conditions. Actual results could differ from those estimates and assumptions. We discuss the development and selection of the critical accounting estimates with the Audit Committee of our Board of Directors on a quarterly basis, and the Audit Committee has reviewed the Company's related disclosure in this Quarterly Report on Form 10-Q. The accounting policies that reflect our more significant estimates, judgments and assumptions and which we believe are the most critical to aid in fully understanding and evaluating our reported financial results include the following:

Revenue Recognition

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Inventories

Warranty

Allowance for Doubtful Accounts

Stock-Based Compensation

Contingencies and Litigation

Goodwill and Intangible Assets

Income Taxes

System revenues recognized without a written acceptance from the customer were approximately 25%, 22% and 10% of total revenues for the three months ended March 31, 2010, December 31, 2009 and March 31, 2009, respectively. The percentage of system revenues recognized without a written acceptance from the customer for the three months ended March 31, 2010 has increased compared to the three months ended December 31, 2009 and March 31, 2009 primarily due to higher shipments of tools that have already met the required acceptance criteria at those customer fabs.

During the three months ended December 31, 2009, we adopted two amendments to the authoritative guidance related to revenue recognition for certain arrangements with software elements and for multiple deliverables. The implementation resulted in additional qualitative disclosures but did not have a material impact on our critical accounting estimates and policies. Please refer to Management's Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended June 30, 2009 for a more complete discussion of our critical accounting policies and estimates.

Revenue Recognition for Certain Arrangements with Software Elements and/or Multiple Deliverables

In October 2009, the Financial Accounting Standards Board (FASB) amended the accounting standards for revenue recognition to remove tangible products containing software components and non-software components that function together to deliver the product's essential functionality from the scope of industry-specific software revenue recognition guidance. In October 2009, the FASB also amended the accounting standards for multiple deliverable revenue arrangements to:

provide updated guidance on how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method; and

require an entity to allocate revenue in an arrangement using estimated selling prices (ESP) of deliverables if it does not have vendor-specific objective evidence (VSOE) or third-party evidence (TPE) of selling price. Valuation terms are defined as follows:

VSOE the price at which we sell the element in a separate stand-alone transaction.

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TPE evidence from us or other companies of the value of a largely interchangeable element in a transaction.

ESP our best estimate of the selling price of an element in a transaction.

We elected to early adopt this accounting guidance at the beginning of the second quarter of our fiscal year ending June 30, 2010 and have applied the adoption retrospectively to the beginning of the fiscal year to apply the guidance to transactions originating or materially modified after June 30, 2009. The implementation resulted in additional qualitative disclosures that are included below but did not have a material impact on our financial position, results of operations or cash flows.

For transactions entered into through June 30, 2009, we primarily recognized revenue based upon the guidance in Staff Accounting Bulletin No. 104. During the period, for the majority of our arrangements involving multiple deliverables, the entire amount of the sales contract was allocated to each respective element based on its relative selling price, using fair value. In the limited circumstances when we were not able to determine fair value for the deliverables in the arrangement, but were able to obtain fair value for the undelivered elements, revenue was allocated using the residual method. Under the residual method, the amount of revenue allocated to delivered elements equaled the total arrangement consideration less the aggregate selling price of any undelivered elements, and no revenue was recognized until all elements without fair value had been delivered. If fair value of any undelivered elements did not exist, the entire amount of the sales contract was deferred until all elements were accepted by the customer.

This guidance does not generally change the units of accounting for our revenue transactions. We typically recognize revenue for system sales upon acceptance by the customer that the system has been installed and is operating according to predetermined specifications. Under certain circumstances, however, we recognize revenue upon shipment, prior to written acceptance by the customer. The portion of revenue associated with installation is deferred based on relative sales price and recognized upon completion of the installation. Spare parts revenue is recognized when the product has been shipped and risk of loss has passed to the customer, and collectability is reasonably assured. Service and maintenance contract revenue is recognized ratably over the term of the

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maintenance contract. Revenue from services performed in the absence of a contract, such as consulting and training revenue, is recognized when the related services are performed, and collectability is reasonably assured. Our arrangements generally do not include any provisions for cancellation, termination or refunds that would significantly impact recognized revenue.

We enter into revenue arrangements that may consist of multiple deliverables of our products and services where certain elements of a sales contract are not delivered and accepted in one reporting period.

In many instances, products are sold in stand-alone arrangements. Services are sold separately through renewals of annual maintenance contracts. As a result, for substantially all of the arrangements with multiple deliverables pertaining to products and services, we use VSOE or TPE to allocate the selling price to each deliverable. We determine TPE based on historical prices charged for products and services when sold on a stand-alone basis.

When we are unable to establish relative selling price using VSOE or TPE, we use ESP in our allocation of arrangement consideration. The objective of ESP is to determine the price at which we would transact a sale if the product or service were sold on a stand-alone basis. ESP could potentially be used for new or customized products.

We regularly review relative selling prices and maintain internal controls over the establishment and updates of these estimates.

In terms of the timing and pattern of revenue recognition, the new accounting guidance for revenue recognition is not expected to have a significant effect on revenues in periods after the initial adoption when applied to multiple element arrangements based on current sales strategies.

Valuation of Goodwill and Intangible Assets

We assess goodwill for impairment annually as well as whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Long-lived intangible assets are tested for recoverability whenever events or changes in circumstances indicate that their carrying amounts may not be recoverable.

We completed our annual evaluation of goodwill by reporting unit during the three months ended December 31, 2009 and concluded that there was no impairment.

During the fiscal year ended June 30, 2009, we completed our annual evaluation of goodwill by reporting unit as of December 31, 2008. As a result of the global economic downturn, reductions to our revenue, operating income, and cash flow forecasts, and a significant reduction in our market capitalization, we determined that the goodwill related to our Metrology reporting unit was impaired as of December 31, 2008. As a result, we recorded an impairment charge of \$272.1 million, which represented the entire goodwill amount related to the Metrology reporting unit, during the three months ended December 31, 2008. Our assessment of goodwill impairment indicated that the fair values of our Defect Inspection, Service, and Other reporting units exceeded their estimated carrying values, and therefore goodwill in those reporting units was not impaired.

Adoption of Fair Value Measurement

We adopted authoritative guidance for fair value measurements as of the beginning of fiscal year 2009. In February 2008, the FASB issued a provision that allowed companies to elect a one-year delay in applying the fair value measurements guidance to certain fair value measurements, primarily related to non-financial assets and liabilities. We elected the delayed adoption date for our non-financial assets and liabilities impacted by the guidance. This guidance defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles and enhances disclosures about fair value measurements. Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs. The adoption of the guidance relating to the fair value measurement of non-financial assets and liabilities on July 1, 2009 did not have a material impact on our condensed consolidated results of operations or financial condition. See Note 2, Fair Value Measurements, to the condensed consolidated financial statements.

Concurrently with the adoption of the fair value measurement and disclosure provisions, we adopted authoritative guidance that permits entities to elect, at specified election dates, to measure eligible financial instruments at fair value. See Note 2, Fair Value Measurements, to the condensed consolidated financial statements.

Recent Accounting Pronouncements In February 2010, the Securities and Exchange Commission (SEC) issued a policy statement and staff work plan regarding the potential use by U.S. issuers of financial statements prepared in accordance with International Financial Reporting Standards (IFRS). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board. Under the proposed timeline set forth by the SEC, we could be required in fiscal year 2015 to prepare financial statements in accordance with IFRS, and the SEC is expected to make a determination in 2011 regarding the mandatory adoption of IFRS. We are currently assessing the impact that this potential change would have on our consolidated financial statements, and we will continue to monitor the development of the potential implementation of IFRS.

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In February 2010, the FASB amended its guidance on subsequent events. The amendment states that entities that are required to file or furnish their financial statements with the SEC are no longer required to disclose the date through which the entity has evaluated subsequent events. This amendment is effective for our interim reporting period ended March 31, 2010, and the implementation did not have an impact on our financial position, results of operations or cash flows as it is disclosure-only in nature.

In January 2010, the FASB issued authoritative guidance for fair value measurements. This guidance now requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and also to describe the reasons for these transfers. This authoritative guidance also requires enhanced disclosure of activity in Level 3 fair value measurements. The guidance for Level 1 and Level 2 fair value measurements is effective for our interim reporting period ended March 31, 2010. The implementation did not have an impact on our financial position, results of operations or cash flows as it is disclosure-only in nature. The guidance for Level 3 fair value measurements disclosures becomes effective for our interim reporting period ending September 30, 2011, and we do not expect that this guidance will have an impact on our financial position, results of operations or cash flows as it is disclosure-only in nature.

In October 2009, the FASB amended its Emerging Issues Task Force (EITF) authoritative guidance addressing revenue arrangements with multiple deliverables. The guidance requires revenue to be allocated to multiple elements using relative fair value based on vendor-specific objective evidence, third-party evidence or estimated selling price. The residual method also becomes obsolete under this guidance. This guidance is effective for our interim reporting period ending September 30, 2010, and allows for early adoption. We elected to early adopt the accounting guidance at the beginning of the second quarter of our fiscal year ending June 30, 2010 and have applied the adoption retrospectively to the beginning of the fiscal year to apply the guidance to transactions originating or materially modified after June 30, 2009. The implementation resulted in additional qualitative disclosures but did not have a material impact on our financial position, results of operations or cash flows.

In October 2009, the FASB amended the authoritative guidance addressing certain revenue arrangements that include software elements. This guidance states that tangible products with hardware and software components that work together to deliver the product functionality are considered non-software products, and the accounting guidance for revenue arrangements with multiple deliverables is to be followed with respect to such products. This guidance is effective for our interim reporting period ending September 30, 2010, and allows for early adoption. We elected to early adopt the accounting guidance at the beginning of the second quarter of our fiscal year ending June 30, 2010 and have applied the adoption retrospectively to the beginning of the fiscal year to apply the guidance to transactions originating or materially modified after June 30, 2009. The implementation resulted in additional qualitative disclosures but did not have a material impact on our financial position, results of operations or cash flows.

In August 2009, the FASB issued authoritative guidance for measuring liabilities at fair value that reaffirms the previously existing definition of fair value and reintroduces the concept of entry value into the determination of fair value of liabilities. Entry value is the amount an entity would receive to enter into an identical liability. The guidance was effective for our interim reporting period ended December 31, 2009. The implementation did not have a material impact on our financial position, results of operations or cash flows.

In June 2009, the FASB issued authoritative guidance for consolidations that changes how a company determines when an entity that is insufficiently capitalized or is not controlled through voting (or similar rights) should be consolidated. The determination of whether a company is required to consolidate an entity is based on, among other things, an entity's purpose and design and a company's ability to direct the activities of the entity that most significantly impact the entity's economic performance. This guidance is effective for our interim reporting period ending September 30, 2010. We are currently evaluating the impact of the implementation on our financial position, results of operations and cash flows.

In June 2009, the FASB issued authoritative guidance to establish the FASB Accounting Standards Codification as the source of authoritative accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles in the United States. This guidance was effective for our interim reporting period ended September 30, 2009 and only impacted references for accounting guidance.

In April 2009, the FASB issued authoritative guidance for business combinations that amends the provisions related to the initial recognition and measurement, subsequent measurement and disclosure of assets and liabilities arising from contingencies in a business combination. This guidance will require such contingencies to be recognized at fair value on the acquisition date if fair value can be reasonably estimated during the allocation period. Otherwise, entities would typically account for the acquired contingencies in accordance with authoritative guidance for contingencies. The guidance became effective for our business combinations for which the acquisition date is on or after July 1, 2009. We did not complete any material business combinations during the three or nine months ended March 31, 2010, and the effect of this guidance, if any, on our financial position, results of operations and cash flows in future periods will depend on the nature and significance of business combinations subject to this guidance.

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In April 2009, the FASB issued authoritative guidance to increase the frequency of fair value disclosures of financial instruments, thereby enhancing consistency in financial reporting. The guidance relates to fair value disclosures for any financial instruments that are not currently reflected on a company's balance sheet at fair value. Prior to the effective date of this guidance, fair

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values for these types of financial assets and liabilities have only been disclosed once a year. The guidance requires these disclosures on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. The disclosure requirement under this guidance was effective for our interim reporting period ended September 30, 2009. The implementation did not have an impact on our financial position, results of operations or cash flows as it is disclosure-only in nature.

In December 2008, the FASB issued authoritative guidance for an employer's disclosures about plan assets of a defined benefit pension or other post-retirement plan. The guidance requires annual disclosures surrounding how investment allocation decisions are made, including the factors that are pertinent to an understanding of investment policies and strategies. The annual disclosure requirement under this guidance is effective for our fiscal year ending June 30, 2010. The guidance does not change the accounting treatment for post-retirement benefit plans.

In April 2008, the FASB issued authoritative guidance for general intangibles other than goodwill, amending the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. This guidance is effective for intangible assets acquired on or after July 1, 2009. The adoption did not have a material impact on our financial position, results of operations or cash flows.

EXECUTIVE SUMMARY

KLA-Tencor Corporation is a leading supplier of process control and yield management solutions for the semiconductor and related nanoelectronics industries. Within our primary area of focus, our comprehensive portfolio of products, services, software and expertise helps integrated circuit (IC or chip) manufacturers manage yield throughout the entire wafer fabrication process from research and development to final volume production. In addition to the semiconductor industry, our technologies serve a number of other industries, including light emitting diode (LED), data storage, solar process development and control, and general materials research.

Our products and services are used by virtually every major wafer, IC and photomask manufacturer in the world. Our revenues are driven largely by capital spending by our customers who operate in one or more of several key semiconductor markets, including the memory, foundry and logic markets. Our customers purchase our products either in response to the need to drive advances in process technologies or to ramp up production to satisfy demand from industries such as communication, data processing, consumer electronics, automotive and aerospace. We believe that, over the long term, our customers will continue to invest in advanced technologies and new materials to enable smaller design rules and higher density applications, as well as reduced cost, which in turn will drive increased adoption of process control to reduce defectivity.

As a supplier to the global semiconductor and semiconductor-related industries, we are subject to business cycles, the timing, length and volatility of which can be difficult to predict. The industries we serve have historically been cyclical due to sudden changes in demand and manufacturing capacity. Our ability to predict future capacity-related capital spending by our customers is extremely limited, as such spending is very closely connected to the unpredictable business cycles within their industries. We expect our customers' capital spending on process control to increase over the long term, driven by the demand for more precise diagnostics capabilities to address new defects as a result of shrinking of device feature sizes, the transition to new materials, new device and circuit architecture, new lithography challenges and fab process innovation.

The demand for our products is generally affected by the profitability of our customers, which is driven by capacity and market supply for their products, as well as the willingness and ability of our customers to invest in new technologies. While semiconductor content in communication, data processing, consumer electronics, automotive and aerospace products continues to increase, the global economic weakness during the fiscal year ended June 30, 2009 adversely impacted our customers that operate in those industries and consequently impacted the demand for our products. However, over the past four quarters, the outlook for economic growth, end product demand for our customers' products and factory utilization of our customers has improved, resulting in an increase in the demand for semiconductor capital equipment. As our customers accelerate capital investments, we have started to increase production volumes to support anticipated customer demand. However, we cannot predict the duration and sustainability of the improving business conditions. As we increase production volumes and make commitments to increase our capacity in anticipation of improved business conditions, we remain at risk of incurring inventory-related and other restructuring charges if the recent improved business conditions do not continue.

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The following table sets forth some of the key quarterly unaudited financial information that we use to manage our business:

(In thousands, except net income (loss) per share)	Three months ended				Three months ended		September
	March 31, 2010	December 31, 2009	September 30, 2009	June 30, 2009	March 31, 2009	December 31, 2008	30, 2008
Total revenues	\$ 478,299	\$ 440,355	\$ 342,687	\$ 281,502	\$ 309,612	\$ 396,589	\$ 532,513
Total costs and operating expenses	\$ 387,020	\$ 393,260	\$ 327,737	\$ 316,469	\$ 381,893	\$ 902,220	\$ 497,575
Income (loss) from operations	\$ 91,279	\$ 47,095	\$ 14,950	\$ (34,967)	\$ (72,281)	\$ (505,631)	\$ 34,938
Net income (loss)	\$ 57,016	\$ 21,794	\$ 20,405	\$ (25,576)	\$ (82,827)	\$ (434,254)	\$ 19,289
Net income (loss) per share:							