KLA TENCOR CORP
Form 10-Q
April 29, 2011
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
T Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended: March 31, 2011
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 000-09992

KLA-Tencor Corporation
(Exact name of registrant as specified in its charter)

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 x 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 x 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 x	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 x

As of April 14, 2011, there were 167,903,024 shares of the registrant's Common Stock, $0.001 par value, outstanding.

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PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS
KLA-TENCOR CORPORATION
Condensed Consolidated Balance Sheets
(Unaudited)

(In thousands)	March 31, 2011	June 30, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$638,758	$529,918
Marketable securities	1,200,816	1,004,126
Accounts receivable, net	566,069	440,125
Inventories, net	556,798	401,730
Deferred income taxes	306,563	328,522
Other current assets	161,887	131,044
Total current assets	3,430,891	2,835,465
Land, property and equipment, net	250,571	236,752
Goodwill	328,159	328,006
Purchased intangibles, net	93,855	117,336
Other non-current assets	345,867	389,497
Total assets	$4,449,343	$3,907,056
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$142,126	$107,938
Deferred system profit	230,069	204,764
Unearned revenue	45,908	37,026
Other current liabilities	438,634	422,059
Total current liabilities	856,737	771,787
Non-current liabilities:		
Long-term debt	746,154	745,747
Income tax payable	68,178	53,492
Unearned revenue	35,064	20,354
Other non-current liabilities	70,193	69,065
Total liabilities	1,776,326	1,660,445
Commitments and contingencies (Note 12 and Note 13)		
Stockholders' equity:		
Common stock and capital in excess of par value	1,006,949	921,460
Retained earnings	1,674,589	1,356,454
Accumulated other comprehensive income (loss)	(8,521)	(31,303)
Total stockholders' equity	2,673,017	2,246,611
Total liabilities and stockholders' equity	$4,449,343	$3,907,056

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

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KLA-TENCOR CORPORATION
Condensed Consolidated Statements of Operations
(Unaudited)

	Three months ended March 31,		Nine months ended March 31,	
(In thousands, except per share data)	2011	2010	2011	2010
Revenues:				
Product	$691,270	$349,787	$1,869,736	$893,984
Service	142,789	128,512	412,992	367,357
Total revenues	834,059	478,299	2,282,728	1,261,341
Costs and operating expenses:				
Costs of revenues	327,696	208,565	903,063	587,743
Engineering, research and development	95,617	84,741	285,234	246,251
Selling, general and administrative	98,967	93,714	278,170	274,023
Total costs and operating expenses	522,280	387,020	1,466,467	1,108,017
Income from operations	311,779	91,279	816,261	153,324
Interest income and other, net	3,150	3,084	193	28,846
Interest expense	13,409	14,092	40,431	41,091
Income before income taxes	301,520	80,271	776,023	141,079
Provision for income taxes	91,737	23,255	226,552	41,864
Net income	$209,783	$57,016	$549,471	$99,215
Net income per share:				
Basic	$1.25	$0.33	$3.29	$0.58
Diluted	$1.22	$0.33	$3.23	$0.57
Cash dividend paid per share	$0.25	$0.15	$0.75	$0.45
Weighted average number of shares:				
Basic	167,629	171,506	166,978	171,202
Diluted	171,313	173,357	169,974	173,432

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

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KLA-TENCOR CORPORATION
Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Nine months ended March 31,	
(In thousands)	2011	2010
Cash flows from operating activities:		
Net income	$549,471	$99,215
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	63,511	67,794
Asset impairment charges	7,385	10,592
Gain on sale of real estate assets	(1,372)	(2,984)
Non-cash stock-based compensation expense	62,491	62,523
Tax charge from equity awards	—	(5,133)
Net gain on sale of marketable securities and other investments	(1,899)	(3,689)
Changes in assets and liabilities, net of assets acquired and liabilities assumed in business combinations:		
Increase in accounts receivable, net	(114,301)	(107,361)
Increase in inventories	(150,016)	(1,254)
Decrease (increase) in other assets	(71,109)	75,299
Increase in accounts payable	33,674	28,459
Increase in deferred system profit	25,306	71,136
Increase in other liabilities	130,223	69,925
Net cash provided by operating activities	533,364	364,522
Cash flows from investing activities:		
Acquisition of business, net of cash received	—	(1,500)
Capital expenditures, net	(36,544)	(24,411)
Proceeds from sale of assets	18,185	5,878
Purchase of available-for-sale securities	(757,265)	(863,289)
Proceeds from sale and maturity of available-for-sale securities	536,718	643,962
Purchase of trading securities	(48,822)	(54,555)
Proceeds from sale of trading securities	67,084	64,975
Net cash used in investing activities	(220,644)	(228,940)
Cash flows from financing activities:		
Issuance of common stock	106,648	23,813
Tax withholding payments related to vested and released restricted stock units	(22,075)	(12,913)
Common stock repurchases	(176,870)	(54,630)
Payment of dividends to stockholders	(125,536)	(77,023)
Net cash used in financing activities	(217,833)	(120,753)
Effect of exchange rate changes on cash and cash equivalents	13,953	3,709
Net increase in cash and cash equivalents	108,840	18,538
Cash and cash equivalents at beginning of period	529,918	524,967
Cash and cash equivalents at end of period	$638,758	$543,505
Supplemental cash flow disclosures:		
Income taxes paid (refund received), net	$196,988	$(42,971)
Interest paid	$26,743	$26,432

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 U.S. 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, 2010, filed with the SEC on August 6, 2010.

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.

References in this Quarterly Report on Form 10-Q to "authoritative guidance" are to the Accounting Standards Codification issued by the Financial Accounting Standards Board ("FASB") in June 2009.

The results of operations for the three and nine months ended March 31, 2011 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, 2011.

Certain reclassifications have been made to the prior year's Condensed Consolidated Balance Sheet and notes 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 December 2010, the FASB amended its guidance on goodwill and other intangible assets. The amendment modifies Step 1 of the goodwill impairment test for reporting units with zero or negative carrying amounts. For those reporting units, an entity is required to perform Step 2 of the goodwill impairment test if there are qualitative factors indicating that it is more likely than not that a goodwill impairment exists. The qualitative factors are consistent with the existing guidance which requires goodwill of a reporting unit to be tested for impairment between annual tests if an event occurs or circumstances change that would more likely than not reduce the fair value of a reporting unit below its carrying amount. This amendment was effective for the Company's interim period ended March 31, 2011. The amendment did not have an impact on the Company's financial position, results of operations or cash flows.

In December 2010, the FASB amended its guidance on business combinations. Under the amended guidance, a public entity that presents comparative financial statements must disclose the revenue and earnings of the combined entity as though the business combination(s) that occurred during the current year had occurred as of the beginning of the prior annual reporting period. The amendment is effective prospectively for business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2010. Early adoption is permitted. The Company does not expect the implementation to have an impact on its financial position, results of operations or cash flows.

In April 2010, the FASB amended its guidance on share-based payment awards with an exercise price denominated in certain currencies. The amendment clarifies that an employee share-based payment award with an exercise price denominated in the currency of a market in which a substantial portion of the entity's equity securities trades should not be considered to contain a condition that is not a market, performance, or service condition. Therefore, an entity would not classify such an award as a liability if it otherwise qualifies as equity. This amendment becomes effective for the Company's interim period ending September 30, 2011. The Company does not expect the implementation to have an impact on its financial position, results of operations or cash flows.

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

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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 was 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.

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

In October 2009, the FASB issued amended revenue recognition guidance for arrangements with multiple deliverables and certain software sold with tangible products. This guidance eliminates the residual method of revenue recognition and allows the use of management's best estimate of selling price for individual elements of an arrangement when vendor-specific objective evidence ("VSOE") or third-party evidence ("TPE") is unavailable. The Company elected to early adopt this accounting guidance at the beginning of its second quarter of the fiscal year ended June 30, 2010 and 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 as this guidance does not generally change the units of accounting for the Company's revenue transactions.

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 estimated selling prices (“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.

NOTE 2 – FAIR VALUE MEASUREMENTS

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.

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 are described below:

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Level 1	Valuations based on quoted prices in active markets for identical assets or liabilities that the entity has the ability to access.
Level 2	Valuations based on quoted prices for similar assets or liabilities, 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.

All of the Company's financial instruments were classified within Level 1 or Level 2 of the fair value hierarchy as of March 31, 2011, because they were 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, U.S. agency securities, 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, municipal obligations and sovereign securities. 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 that were held by the Company as of and prior to June 30, 2010. Such instruments were 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 included estimates for interest rates, timing and amount of cash flows and expected holding periods of the auction rate securities.

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Financial assets and liabilities measured at fair value on a recurring basis as of March 31, 2011 were 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)
U.S. Treasuries	$92,968	$65,422	$27,546	$ —
U.S. Government agency securities	284,142	284,142		