KLA TENCOR CORP
Form 10-Q
October 28, 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 September 30, 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 | 04-2564110 |
| (State or other jurisdiction of incorporation or organization) | (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 website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 October 13, 2011, there were 166,664,427 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) | September 30, 2011 | June 30, 2011 |
|---|---|---|
| ASSETS | | |
| Current assets: | | |
| Cash and cash equivalents | $745,947 | $711,329 |
| Marketable securities | 1,354,204 | 1,327,206 |
| Accounts receivable, net | 461,640 | 583,270 |
| Inventories, net | 612,603 | 575,730 |
| Deferred income taxes | 290,372 | 331,397 |
| Other current assets | 132,153 | 147,078 |
| Total current assets | 3,596,919 | 3,676,010 |
| Land, property and equipment, net | 264,279 | 257,358 |
| Goodwill | 327,971 | 328,156 |
| Purchased intangibles, net | 77,949 | 85,902 |
| Other non-current assets | 298,199 | 328,095 |
| Total assets | $4,565,317 | $4,675,521 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Accounts payable | $114,575 | $142,945 |
| Deferred system profit | 136,122 | 192,338 |
| Unearned revenue | 47,311 | 44,264 |
| Other current liabilities | 436,211 | 499,314 |
| Total current liabilities | 734,219 | 878,861 |
| Non-current liabilities: | | |
| Long-term debt | 746,425 | 746,290 |
| Income tax payable | 37,978 | 78,337 |
| Unearned revenue | 38,857 | 34,905 |
| Other non-current liabilities | 73,243 | 76,235 |
| Total liabilities | 1,630,722 | 1,814,628 |
| Commitments and contingencies (Note 12 and Note 13) | | |
| Stockholders' equity: | | |
| Common stock and capital in excess of par value | 1,031,157 | 1,010,659 |
| Retained earnings | 1,910,403 | 1,852,633 |
| Accumulated other comprehensive income (loss) | (6,965) | (2,399) |
| Total stockholders' equity | 2,934,595 | 2,860,893 |
| Total liabilities and stockholders' equity | $4,565,317 | $4,675,521 |

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 September 30, | |
|---|---|---|
| (In thousands, except per share data) | 2011 | 2010 |
| Revenues: | | |
| Product | $650,256 | $550,609 |
| Service | 146,220 | 131,733 |
| Total revenues | 796,476 | 682,342 |
| Costs and operating expenses: | | |
| Costs of revenues | 340,349 | 263,969 |
| Engineering, research and development | 107,762 | 94,720 |
| Selling, general and administrative | 94,076 | 88,037 |
| Total costs and operating expenses | 542,187 | 446,726 |
| Income from operations | 254,289 | 235,616 |
| Interest income and other, net | 6,866 | 1,225 |
| Interest expense | 13,893 | 13,529 |
| Income before income taxes | 247,262 | 223,312 |
| Provision for income taxes | 55,267 | 69,116 |
| Net income | $191,995 | $154,196 |
| Net income per share: | | |
| Basic | $1.15 | $0.92 |
| Diluted | $1.13 | $0.91 |
| Cash dividends declared per share | $0.35 | $0.25 |
| Weighted average number of shares: | | |
| Basic | 166,684 | 167,187 |
| Diluted | 169,835 | 169,839 |

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

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

| (In thousands) | Three months ended September 30, 2011 | 2010 |
|---|---|---|
| Cash flows from operating activities: | | |
| Net income | $191,995 | $154,196 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 23,184 | 20,783 |
| Non-cash stock-based compensation expense | 20,496 | 24,213 |
| Net gain on sale of marketable securities and other investments | (662) | (1,047) |
| Changes in assets and liabilities: | | |
| Decrease (increase) in accounts receivable, net | 129,227 | (50,342) |
| Increase in inventories, net | (43,699) | (63,450) |
| Decrease in other assets | 91,789 | 10,870 |
| Increase (decrease) in accounts payable | (28,558) | 30,096 |
| Decrease in deferred system profit | (56,216) | (3,101) |
| Decrease in other liabilities | (108,571) | (26,690) |
| Net cash provided by operating activities | 218,985 | 95,528 |
| Cash flows from investing activities: | | |
| Capital expenditures, net | (12,128) | (11,163) |
| Purchase of available-for-sale securities | (303,101) | (228,951) |
| Proceeds from sale and maturity of available-for-sale securities | 268,931 | 239,650 |
| Purchase of trading securities | (18,586) | (16,004) |
| Proceeds from sale of trading securities | 16,176 | 30,623 |
| Net cash provided by (used in) investing activities | (48,708) | 14,155 |
| Cash flows from financing activities: | | |
| Issuance of common stock | 9,702 | 2,953 |
| Tax withholding payments related to vested and released restricted stock units | (17,930) | (9,517) |
| Common stock repurchases | (66,392) | (62,156) |
| Payment of dividends to stockholders | (58,460) | (41,785) |
| Net cash used in financing activities | (133,080) | (110,505) |
| Effect of exchange rate changes on cash and cash equivalents | (2,579) | 9,288 |
| Net increase in cash and cash equivalents | 34,618 | 8,466 |
| Cash and cash equivalents at beginning of period | 711,329 | 529,918 |
| Cash and cash equivalents at end of period | $745,947 | $538,384 |
| Supplemental cash flow disclosures: | | |
| Income taxes paid, net | $37,391 | $46,060 |
| Interest paid | $611 | $352 |

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, 2011, filed with the SEC on August 5, 2011.

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 results of operations for the three months ended September 30, 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, 2012.

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.

Revenue Recognition. KLA-Tencor recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectability is reasonably assured. 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, 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.

The Company also allows for multiple element revenue arrangements in cases where certain elements of a sales arrangement are not delivered and accepted in one reporting period. In such cases, the Company defers the relative fair value of the undelivered elements until that element is delivered to the customer. To be considered a separate element, the product or service in question must represent a separate unit of accounting and fulfill the following criteria: (a) the delivered item(s) has value to the customer on a stand-alone basis; (b) there is objective and reliable evidence of the fair value of the undelivered item(s); and (c) if the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company. If the arrangement does not meet all the above criteria, the entire amount of the sales contract is deferred until all elements are accepted by the customer.

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 vendor-specific objective evidence ("VSOE") or third-party evidence ("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.

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When the Company is unable to establish relative selling price using VSOE or TPE, the Company uses estimated selling price ("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 to be 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.

Recent Accounting Pronouncements. In September 2011, the FASB amended its guidance through the issuance of a revised accounting standard intended to simplify testing goodwill for impairment. The amendments allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity will no longer be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that the fair value of the reporting unit is less than its carrying amount. Prior to the amendment, entities were required to test goodwill for impairment, on at least an annual basis, by first comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit is calculated as being less than its carrying amount, then the second step of the quantitative test is to be performed to measure the amount of impairment loss, if any. The amendment becomes effective for annual and interim goodwill impairment tests performed for the Company's fiscal year ending June 30, 2013. Early adoption is permitted. The Company is currently evaluating the impact of the guidance on its financial position, results of operations and cash flows.

In June 2011, the FASB amended its guidance on the presentation of comprehensive income. Under the amended guidance, an entity has the option to present comprehensive income in either one continuous statement or two consecutive financial statements. A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income. In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The option under current guidance that permits the presentation of components of other comprehensive income as part of the statement of changes in stockholders' equity has been eliminated. The amendment becomes effective during the first quarter of the Company's fiscal year ending June 30, 2013. Early adoption is permitted. 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 May 2011, the FASB amended its guidance to converge fair value measurement and disclosure guidance about fair value measurement under U.S. GAAP with International Financial Reporting Standards ("IFRS"). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board. The amendment changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend for the amendment to result in a change in the application of the requirements in the current authoritative guidance. The amendment becomes effective prospectively for the Company's interim reporting period ending March 31, 2012. Early application is not permitted. The Company does not expect the amendment to have a material 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 was effective for the Company’s interim reporting period ended September 30, 2011. The amendment did not have an impact on the Company's 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 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 of that guidance 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 was effective for the Company’s interim reporting period ended September 30, 2011, and the implementation of that guidance did not have an impact on the Company's financial position, results of operations or cash flows as it is disclosure-only in nature.

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NOTE 2 – FAIR VALUE MEASUREMENTS

The Company's financial assets and liabilities 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 land, property 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:

| | |
|---|---|
| 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 September 30, 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 and certain U.S. Government agency securities, U.S. Treasury securities and sovereign 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 commercial paper, corporate debt securities, municipal securities and certain U.S. Government agency securities, U.S. Treasury securities 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 included the auction rate securities that were held by the Company as of and prior to June 30, 2010. Such instruments were 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 (excluding cash held in operating accounts and time deposits) and liabilities measured at fair value on a recurring basis were presented on the Company's Condensed Consolidated Balance Sheet as of September 30, 2011 as follows:

| (In thousands) | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) |
|---|---|---|---|
| Assets | | | |
| Cash equivalents: | | | |
| Money market and other | $578,442 | $578,442 | $— |
| Marketable securities: | | | |
| U.S. Treasury securities | 71,186 | 65,387 | 5,799 |
| U.S. Government agency securities | 344,132 | 342,734 | 1,398 |
| Municipal securities | 40,338 | — | 40,338 |
| Corporate debt securities | 831,721 | — | 831,721 |
| Sovereign securities | 32,411 | 13,385 | 19,026 |
| Total cash equivalents and marketable securities(1) | 1,898,230 | 999,948 | 898,282 |
| Other current assets: | | | |
| Derivative assets | 845 | — | 845 |
| Other non-current assets: | | | |
| Executive Deferred Savings Plan: | | | |
| Money market and other | 4,967 | 4,967 | — |
| Mutual funds | 110,923 | 85,709 | 25,214 |
| Executive Deferred Savings Plan total | 115,890 | 90,676 | 25,214 |
| Total financial assets(1) | $2,014,965 | $1,090,624 | $924,341 |
| Other current liabilities: | | | |
| Derivative liabilities | $(6,054) | $— | $(6,054) |
| Total financial liabilities | $(6,054) | $— | $(6,054) |

(1) Excludes cash of $156.8 million held in operating accounts and time deposits of $45.1 million as of September 30, 2011.

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Financial assets (excluding cash held in operating accounts and time deposits) and liabilities measured at fair value on a recurring basis were presented on the Company's Condensed Consolidated Balance Sheet as of June 30, 2011 as follows:

| (In thousands) | Total | Quoted Prices in Active Markets for Identical Assets (Level 1) | Significant Other Observable Inputs (Level 2) |
|---|---|---|---|
| Assets | | | |
| Cash equivalents: | | | |
| U.S. Treasury securities | $4,400 | $— | $4,400 |
| U.S. Government agency securities | 6,010 | 6,010 | — |
| Corporate debt securities | 21,982 | — | 21,982 |
| Money market and other | 481,770 | 481,770 | — |
| Marketable securities: | | | |
| U.S. Treasury securities | 54,496 | 52,396 | 2,100 |
| U.S. Government agency securities | 314,173 | 314,173 | — |
| Municipal securities | 38,957 | — | 38,957 |
| Corporate debt securities | 853,403 | — | 853,403 |
| Sovereign securities | 32,086 | 14,696 | 17,390 |
| Total cash equivalents and marketable securities(1) | 1,807,277 | 869,045 | 938,232 |
| Other current assets: | | | |
| Derivative assets | 1,970 | — | 1,970 |
| Other non-current assets: | | | |
| Executive Deferred Savings Plan: | | | |
| Money market and other | 1,806 | 1,806 | — |
| Mutual funds | 126,227 | 95,971 | 30,256 |
| Executive Deferred Savings Plan total | 128,033 | 97,777 | 30,256 |
| Total financial assets(1) | $1,937,280 | $966,822 | $970,458 |
| Other current assets: | | | |
| Derivative liabilities | $(2,127) | $— | $(2,127) |
| Total financial liabilities | $(2,127) | $— | $(2,127) |

(1) Excludes cash of $165.9 million held in operating accounts and time deposits of $65.4 million as of June 30, 2011.

Changes in the Company's Level 3 securities for the three months ended September 30, 2011 and 2010 were as follows:

| (In thousands) | Three months ended September 30, 2011 | 2010 |
|---|---|---|
| Beginning aggregate fair value of Level 3 securities | $— | $16,825 |
| Net settlements | — | (16,825) |
| Ending aggregate fair value of Level 3 securities | $— | $— |

During the fiscal year ended June 30, 2010 (and in prior fiscal years), the Company's investment portfolio included auction rate securities, which were investments with contractual maturities generally between 20 to 30 years. In February 2008, because sell orders exceeded buy orders, auctions failed for approximately $48.2 million in par value of municipal auction rate securities that were then held by the Company. 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 with UBS on November 11, 2008. On June 30, 2010 UBS repurchased the Company's $16.8 million then-remaining auction rate securities at par

value, and the repurchase was subsequently settled in July 2010.



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NOTE 3 – BALANCE SHEET COMPONENTS

| (In thousands) | As of September 30, 2011 | As of June 30, 2011 |
|---|---|---|
| Accounts receivable, net: | | |
| Accounts receivable, gross | $484,028 | $605,376 |
| Allowance for doubtful accounts | (22,388) | (22,106) |
| | $461,640 | $583,270 |
| Inventories, net: | | |
| Customer service parts | $155,425 | $148,466 |
| Raw materials | 230,855 | 235,605 |
| Work-in-process | 158,834 | 131,804 |
| Finished goods | 67,489 | 59,855 |
| | $612,603 | $575,730 |
| Other current assets: | | |
| Prepaid expenses | $52,601 | $61,796 |
| Income tax related receivables | 58,866 | 59,774 |
| Other current assets | 20,686 | 25,508 |
| | $132,153 | $147,078 |
| Land, property and equipment, net: | | |
| Land | $41,872 | $41,956 |
| Buildings and leasehold improvements | 234,512 | 234,173 |
| Machinery and equipment | 457,103 | 447,772 |
| Office furniture and fixtures | 20,527 | 19,645 |
| Construction in process | 8,689 | 6,979 |
| | 762,703 | 750,525 |
| Less: accumulated depreciation and amortization | (498,424) | (493,167) |
| | $264,279 | $257,358 |
| Other non-current assets: | | |
| Executive Deferred Savings Plan(1) | $115,890 | $128,033 |
| Deferred tax assets – long-term | 156,619 | 173,788 |
| Other | 25,690 | 26,274 |
| | $298,199 | $328,095 |
| Other current liabilities: | | |
| Warranty | $43,603 | $41,528 |
| Executive Deferred Savings Plan(1) | 115,467 | 128,088 |
| Compensation and benefits | 123,802 | 186,761 |
| Income taxes payable | 12,313 | 16,364 |
| Interest payable | 21,706 | 8,769 |
| Accrued litigation costs | 2,600 | 4,824 |
| Other accrued expenses | 116,720 | 112,980 |
| | $436,211 | $499,314 |

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(1) KLA-Tencor has a non-qualified deferred compensation plan whereby certain executives and non-employee directors may defer a portion of their compensation. Participants are credited with returns based on their allocation of their account balances among measurement funds. The Company controls the investment of these funds and the participants remain general creditors of KLA-Tencor. Distributions from the plan commence the quarter following a participant's retirement or termination of employment, except in cases where such distributions are required to be delayed in order to avoid a prohibited distribution under Internal Revenue Code Section 409A. As of September 30, 2011, the Company had a deferred compensation plan related asset and liability included as a component of other non-current assets and other current liabilities on its Condensed Consolidated Balance Sheet.

NOTE 4 – MARKETABLE SECURITIES

The amortized cost and fair value of marketable securities as of September 30, 2011 and June 30, 2011 were as follows:

| As of September 30, 2011 (In thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury securities | $70,916 | $306 | $(36) | $71,186 |
| U.S. Government agency securities | 343,721 | 749 | (338) | 344,132 |
| Municipal securities | 40,075 | 266 | (3) | 40,338 |
| Corporate debt securities | 830,229 | 3,688 | (2,196) | 831,721 |
| Money market and other | 578,442 | — | — | 578,442 |
| Sovereign securities | 32,283 | 132 | (4) | 32,411 |
| Subtotal | 1,895,666 | 5,141 | (2,577) | 1,898,230 |
| Add: Time deposits(1) | 45,117 | — | — | 45,117 |
| Less: Cash equivalents | 589,143 | — | — | 589,143 |
| Marketable securities | $1,351,640 | $5,141 | $(2,577) | $1,354,204 |

| As of June 30, 2011 (In thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Fair Value |
|---|---|---|---|---|
| U.S. Treasury securities | $58,754 | $165 | $(23) | $58,896 |
| U.S. Government agency securities | 319,375 | 931 | (123) | 320,183 |
| Municipal securities | 38,688 | 275 | (6) | 38,957 |
| Corporate debt securities | 870,591 | 5,162 | (368) | 875,385 |
| Money market and other | 481,770 | — | — | 481,770 |
| Sovereign securities | 31,932 | 179 | (25) | 32,086 |
| Subtotal | 1,801,110 | 6,712 | (545) | 1,807,277 |
| Add: Time deposits(1) | 65,402 | — | — | 65,402 |
| Less: Cash equivalents | 545,475 | — | (2) | 545,473 |
| Marketable securities | $1,321,037 | $6,712 | $(543) | $1,327,206 |

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(1) Time deposits excluded from fair value measurements.

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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. All unrealized losses are due to changes in market interest rates, bond yields and/or credit ratings. The Company has the ability to realize the full value of all of these investments upon maturity. The following table summarizes the fair value and gross unrealized losses of the Company’s investments that were in an unrealized loss position as of September 30, 2011:

| (In thousands) | Fair Value | Gross Unrealized Losses(1) |
|---|---|---|
| U.S. Treasury securities | $25,868 | $(36) |
| U.S. Government agency securities | 134,278 | (338) |
| Municipal securities | 1,443 | (3) |
| Corporate debt securities | 280,339 | (2,196) |
| Sovereign securities | 2,497 | (4) |
| Total | $444,425 | $(2,577) |

(1) As of September 30, 2011, the amount of total gross unrealized losses that had been in a continuous loss position for 12 months or more was immaterial.

The contractual maturities of securities classified as available-for-sale as of September 30, 2011, regardless of their classification on the Company's Condensed Consolidated Balance Sheet, were as follows:

| (In thousands) | Amortized Cost | Fair Value |
|---|---|---|
| Due within one year | $320,316 | $321,151 |
| Due after one year through three years | 1,031,324 | 1,033,053 |
| | $1,351,640 | $1,354,204 |

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 on the Company's investments for the three months ended September 30, 2011 and 2010 were $0.7 million and $1.0 million, respectively.

NOTE 5 – GOODWILL AND PURCHASED INTANGIBLE ASSETS

Goodwill

The following table presents goodwill balances as of September 30, 2011 and June 30, 2011:

| (In thousands) | As of September 30, 2011 | As of June 30, 2011 |
|---|---|---|
| Gross goodwill balance | $604,557 | $604,742 |
| Accumulated impairment losses | (276,586) | (276,586) |
| Net goodwill balance | $327,971 | $328,156 |

The changes in the gross goodwill balance since June 30, 2011 resulted primarily from foreign currency translation adjustments.

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 performs an annual evaluation of goodwill as of November 30 each year, as well as upon the occurrence of significant events or circumstances that impact the valuation of goodwill. There have been no significant events or circumstances affecting the valuation of goodwill subsequent to the impairment test performed in the three months ended December 31, 2010. The next annual evaluation of the goodwill by reporting unit will be performed in the three months ending December 31, 2011.

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Purchased Intangible Assets

The components of purchased intangible assets as of September 30, 2011 and June 30, 2011 were as follows:

| (In thousands) | | As of September 30, 2011 | | | As of June 30, 2011 | | |
|---|---|---|---|---|---|---|---|
| Category | Range of Useful Lives | Gross Carrying Amount | Accumulated Amortization and Impairment | Net Amount | Gross Carrying Amount | Accumulated Amortization and Impairment | Net Amount |
| Existing technology | 4-7 years | $134,561 | $98,603 | $35,958 | $134,561 | $94,172 | $40,389 |
| Patents | 6-13 years | 57,648 | 42,185 | 15,463 | 57,648 | 40,591 | 17,057 |
| Trade name/Trademark | 4-10 years | 19,893 | 13,303 | 6,590 | 19,893 | 12,907 | 6,986 |
| Customer relationships | 6-7 years | 54,823 | 35,056 | 19,767 | 54,823 | 33,565 | 21,258 |
| Other | 0-1 year | 16,200 | 16,029 | 171 | 16,200 | 15,988 | 212 |
| Total | | $283,125 | $205,176 | $77,949 | $283,125 | $197,223 | $85,902 |

For the three months ended September 30, 2011 and 2010, amortization expense for other intangible assets was $8.0 million and $8.4 million, respectively. Based on the intangible assets recorded as of September 30, 2011, 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) |
|---|---|
| 2012 (remaining 9 months) | $22,276 |
| 2013 | 20,957 |
| 2014 | 15,537 |
| 2015 | 12,771 |
| 2016 | 5,582 |
| 2017 and thereafter | 826 |
| Total | $77,949 |

NOTE 6 – 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 September 30, 2011.

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, 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, by the Company's then-available financial resources 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 obligations.

Based on the trading prices of the debt on September 30, 2011 and June 30, 2011, the fair value of the debt as of September 30, 2011 and June 30, 2011 was $857.4 million and $863.5 million, respectively.

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NOTE 7 – 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 permits the issuance of up to 32.0 million shares of common stock. 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.

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

| (In thousands) | Available For Grant |
|---|---|
| Balances as of June 30, 2011(1) | 11,554 |
| Restricted stock units granted(2)(3) | (3,877) |
| Restricted stock units canceled(2) | 145 |
| Options canceled/expired/forfeited | 196 |
| Plan shares expired(4) | (187) |
| Balances as of September 30, 2011(1) | 7,831 |

(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 members of the Board of Directors. As of September 30, 2011, 1.6 million shares were available for grant under the Outside Director Plan.

(2) The number of restricted stock units provided in this row reflects the application of the 1.8x multiple described above.

(3) Includes 0.2 million restricted stock units granted to senior management during the three months ended September 30, 2011 with performance-based vesting criteria (in addition to service-based vesting criteria for any of such restricted stock units that are deemed to have been earned). As of September 30, 2011, it had not yet been determined the extent to which (if at all) the performance-based vesting criteria of such restricted stock units had been satisfied. Therefore, this line item includes all such performance-based restricted stock units, reported at the maximum possible number of shares that may ultimately be issuable under such restricted stock units if all applicable performance-based and service-based criteria are fully satisfied.

(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 plans do not result in additional shares being available to the Company for future grant.

Except for options granted to non-employee Board members 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 granted at the market price of the Company’s common stock on the date of grant (except for the previously disclosed retroactively priced options which were granted primarily prior to the fiscal year ended June 30, 2002), generally 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.

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 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.

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The following table shows pre-tax stock-based compensation expense for the indicated periods:

| (In thousands) | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Stock-based compensation expense by: | | |
| Costs of revenues | $3,838 | $4,168 |
| Engineering, research and development | 5,821 | 7,618 |
| Selling, general and administrative | 10,837 | 12,427 |
| Total stock-based compensation expense | $20,496 | $24,213 |

The following table shows stock-based compensation capitalized as inventory as of September 30, 2011 and June 30, 2011:

| (In thousands) | As of September 30, 2011 | As of June 30, 2011 |
|---|---|---|
| Inventory | $7,006 | $6,701 |

Stock Options

The following table summarizes the activity and weighted-average exercise price for stock options under all plans during the three months ended September 30, 2011:

| Stock Options | Shares (In thousands) | Weighted-Average Exercise Price |
|---|---|---|
| Outstanding stock options as of June 30, 2011 | 7,675 | $ 45.38 |
| Granted | — | $ — |
| Exercised | (309 ) | $ 31.39 |
| Canceled/expired/forfeited | (196 ) | $ 47.51 |
| Outstanding stock options as of September 30, 2011 | 7,170 | $ 45.93 |
| Vested and exercisable as of September 30, 2011 | 7,167 | $ 45.93 |

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 vested and exercisable under all plans as of September 30, 2011, were 2.1 years and 1.9 years, respectively. The aggregate intrinsic values for total options outstanding under all plans and for total options vested and exercisable under all plans as of September 30, 2011 were each $2.0 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 assumptions, including the option’s expected life and the expected price volatility of the underlying stock. The expected stock price volatility assumption was based on the market-based implied volatility from traded options of the Company’s common 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 indicated periods:

| (In thousands) | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Total intrinsic value of options exercised | $2,760 | $563 |
| Total cash received from employees as a result of employee stock option exercises | $9,702 | $2,953 |
| Tax benefits realized in connection with these exercises | $939 | $202 |

As of September 30, 2011, the unrecognized stock-based compensation balance related to stock options was immaterial.

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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.

Restricted Stock Units

The following table shows the applicable number of restricted stock units and weighted-average grant date fair value after estimated forfeitures for restricted stock units granted, vested and released, withheld for taxes, and forfeited during the three months ended September 30, 2011 and restricted stock units outstanding as of September 30, 2011 and June 30, 2011:

| Restricted Stock Units | Shares (In thousands) (1) | Weighted-Average Grant Date Fair Value |
|---|---|---|
| Outstanding restricted stock units as of June 30, 2011 | 6,540 | $ 21.28 |
| Granted(2) | 2,154 | $ 25.37 |
| Vested and released | (905) | $ 22.56 |
| Withheld for taxes | (479) | $ 22.54 |
| Forfeited | (80) | $ 21.15 |
| Outstanding restricted stock units as of September 30, 2011(2) | 7,230 | $ 22.25 |

(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 is multiplied by 1.8 to calculate the impact on the share reserve under the 2004 Plan.

(2) Includes 0.2 million restricted stock units granted to senior management during the three months ended September 30, 2011 with performance-based vesting criteria (in addition to service-based vesting criteria for any of such restricted stock units that are deemed to have been earned). As of September 30, 2011, it had not yet been determined the extent to which (if at all) the performance-based vesting criteria of such restricted stock units had been satisfied. Therefore, this line item includes all such performance-based restricted stock units, reported at the maximum possible number of shares that may ultimately be issuable under such restricted stock units, if all applicable performance-based and service-based criteria are fully satisfied.

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 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.

The following table shows the grant date fair value after estimated forfeitures, weighted-average grant date fair value per unit and tax benefits realized by the Company in connection with vested and released restricted stock units for the indicated periods:

| (In thousands, except for weighted-average grant date fair value) | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Grant date fair value after estimated forfeitures | $54,637 | $40,705 |
| Weighted-average grant date fair value per unit | $25.37 | $19.52 |
| Tax benefits realized in connection with vested and released restricted stock units | $16,773 | $10,094 |

As of September 30, 2011, the unrecognized stock-based compensation expense balance related to restricted stock units was $138.8 million and will be recognized over an estimated weighted-average amortization period of 2.0 years.

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Employee Stock Purchase Plan

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 closing price of the common stock on the first day of the offering period versus the closing price on the date of purchase (or, if not a trading day, on the immediately preceding trading day).

Effective January 1, 2010, the offering period (or length of the look-back period) under the ESPP has a duration of six months, and the purchase price with respect to each offering period beginning on or after such date is, until otherwise amended, equal to 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 estimates 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 September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Stock purchase plan: | | |
| Expected stock price volatility | 33.0 % | 41.0 % |
| Risk-free interest rate | 0.1 % | 0.2 % |
| Dividend yield | 3.4 % | 3.7 % |
| Expected life of options (in years) | 0.50 | 0.50 |

The following table shows the tax benefits realized by the Company in connection with the disqualifying dispositions of shares purchased under the ESPP and the weighted-average fair value per share for the indicated periods:

| (In thousands, except for weighted-average fair value per share) | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Tax benefits realized in connection with the disqualifying dispositions of shares purchased under the ESPP | $475 | $356 |
| Weighted-average fair value per share based on Black-Scholes model | $9.16 | $6.53 |

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 be issued under the ESPP during the forthcoming fiscal year. During the fiscal year ended June 30, 2011, a total of 2.0 million additional shares were reserved under the ESPP. To date, no additional shares have been reserved under the ESPP with respect to the fiscal year ending June 30, 2012. As of September 30, 2011, a total of 3.5 million shares were reserved and available for issuance under the ESPP.

NOTE 8 – STOCK REPURCHASE PROGRAM

Since July 1997, the Board of Directors has authorized the Company to systematically repurchase in the open market up to 72.8 million shares of its common stock under a repurchase program, including 10.0 million shares authorized in February 2011. 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 stockholders. 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. As of September 30, 2011, 7.3 million shares were available for repurchase under the Company's repurchase program.

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Share repurchases for the three months ended September 30, 2011 and 2010 were as follows:

| | Three months ended September 30, | |
|---|---|---|
| (In thousands) | 2011 | 2010 |
| Number of shares of common stock repurchased | 1,763 | 1,972 |
| Total cost of repurchases | $66,982 | $59,323 |

As of September 30, 2011, $3.3 million of the total cost of repurchases set forth above remained unpaid and was recorded in other current liabilities. The $2.7 million which was accrued as of June 30, 2011 was paid during the three months ended September 30, 2011.

NOTE 9 – NET INCOME PER SHARE

Basic net income per share is calculated by dividing net income available to common stockholders by the weighted-average number of common shares outstanding during the period. Diluted net income 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 net income 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 per share:

| (In thousands, except per share amounts) | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Numerator: | | |
| Net income | $191,995 | $154,196 |
| Denominator: | | |
| Weighted-average shares-basic, excluding unvested restricted stock units | 166,684 | 167,187 |
| Effect of dilutive options and restricted stock units | 3,151 | 2,652 |
| Weighted-average shares-diluted | 169,835 | 169,839 |
| Basic net income per share | $1.15 | $0.92 |
| Diluted net income per share | $1.13 | $0.91 |
| Anti-dilutive securities excluded from the computation of diluted net income per share | 6,635 | 10,340 |

The total amount of dividends paid during the three months ended September 30, 2011 and 2010 was $58.5 million and $41.8 million, respectively. On July 12, 2011, the Company announced that its Board of Directors had authorized an increase in the level of the Company's quarterly dividend from $0.25 to $0.35 per share. The increase in the amount of dividends paid during the three months ended September 30, 2011 reflects that increase in the level of the Company's quarterly dividend.

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NOTE 10 – COMPREHENSIVE INCOME

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

| (In thousands) | Three months ended September 30, 2011 | 2010 |
|---|---|---|
| Net income | $191,995 | $154,196 |
| Other comprehensive income (loss): | | |
| Currency translation adjustments | (1,787) | 13,522 |
| Gains (losses) on cash flow hedging instruments | (626) | 840 |
| Change in unrecognized losses and transition obligation related to pension and post-retirement plans | 103 | 80 |
| Unrealized gains (losses) on investments | (2,256) | 1,750 |
| Other comprehensive income (loss) | (4,566) | 16,192 |
| Total comprehensive income | $187,429 | $170,388 |

NOTE 11 – INCOME TAXES

The following table provides details of income taxes:

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | 2010 |
|---|---|---|
| Income before income taxes | $247,262 | $223,312 |
| Provision for taxes | 55,267 | 69,116 |
| Effective tax rate | 22.4 % | 31.0 % |

The Company’s estimated annual effective tax rate for the fiscal year ending June 30, 2012 is approximately 25.0%. The difference between the actual effective tax rate of 22.4% during the quarter and the estimated annual effective tax rate of 25.0% is primarily due to the tax impact of the following items during the three months ended September 30, 2011:

- Tax benefit of $18.3 million was recognized related to the settlement of a United States federal income tax examination for the fiscal years ended June 30, 2007 through June 30, 2009. During the three months ended September 30, 2011, the Company received acceptance from the Joint Committee of Taxation for the settlement of the U.S. federal income tax examination. As a result of the settlement, the Company reduced its unrecognized tax benefits by $22.0 million.
- Tax benefit of $18.0 million was recognized related to a decrease in reserves for uncertain tax positions taken in prior years.
- Tax expense of $23.6 million was recognized related to an inter-company licensing agreement in connection with the migration of a portion of the Company's manufacturing to Singapore.
- Tax expense of $5.2 million was recognized related to a non-deductible decrease in the value of the assets held within the Company’s Executive Deferred Savings Plan.

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Tax expense was lower as a percentage of income during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to:

- A tax benefit of $18.3 million recognized during the three months ended September 30, 2011 resulting from a decrease in the Company's unrecognized tax benefits due to the settlement of a U.S. federal income tax examination;
- A tax benefit of $18.0 million recognized during the three months ended September 30, 2011 resulting from a decrease in reserves for uncertain tax positions taken in prior years;
- A decrease in tax expense of $6.9 million during the three months ended September 30, 2011 related to state income taxes; and
- A decrease in tax expense of $7.7 million during the three months ended September 30, 2011 related to an increase in the proportion of the Company's earnings generated in jurisdictions with tax rates lower than the U.S. statutory tax rate; partially offset by
- An increase in tax expense of $23.6 million during the three months ended September 30, 2011 related to a migration of a portion of the Company's manufacturing to Singapore.

In the normal course of business, the Company is subject to examination by taxing authorities throughout the world. The Company is subject to federal income tax examination for all years beginning from the year ended June 30, 2010. The Company is subject to state income tax examinations for all years beginning from the fiscal year ended June 30, 2007. The Company is also subject to examinations in other major foreign jurisdictions, including Singapore, for all years beginning from the fiscal year ended June 30, 2007. 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 $1.1 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 examinations with various tax authorities.

NOTE 12 – LITIGATION AND OTHER LEGAL MATTERS

Indemnification Obligations. As a result of the Company's indemnification obligations in connection with the litigation and government inquiries related to the Company's historical stock option practices, the Company is currently paying defense costs for one former officer and employee facing an SEC civil action to which the Company is not a party, and the Company is also obligated to pay the attorneys' fees and expenses incurred by former employees in connection with discovery undertaken in that case. The Company is further incurring costs associated with retaining counsel to respond to discovery requests and otherwise representing the Company in that litigation. Although the maximum potential amount of future payments the Company could be required to make under these arrangements 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 condensed consolidated financial statements are adequate in light of the probable and estimated liabilities. 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 alleged liabilities from the matters described above will not exceed the amounts reflected in the Company's condensed consolidated financial statements or will not have a material adverse effect on its results of operations, financial condition or cash flows.

NOTE 13 – 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. The Company does not believe it is at risk for any material losses as a result of these agreements. In addition, from time to time the Company will discount, without recourse, letters of credit (“LCs”) received from customers in payment for goods.

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The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs for the three months ended September 30, 2011 and 2010:

| (In thousands) | Three months ended September 30, 2011 | September 30, 2010 |
| --- | --- | --- |
| Receivables sold under factoring agreements | $168,724 | $60,025 |
| Proceeds from sales of LCs | $4,510 | $50,831 |

Factoring and LC fees for the sale of certain trade receivables were recorded in interest income and other, net and were not material for the periods presented.

Facilities. KLA-Tencor leases certain of its facilities under arrangements that are accounted for as operating leases. Rent expense was $2.3 million and $2.0 million for the three months ended September 30, 2011 and 2010, respectively.

The following is a schedule of expected operating lease payments:

| Fiscal year ending June 30, | Amount (In thousands) |
| --- | --- |
| 2012 (remaining 9 months) | $6,430 |
| 2013 | 6,394 |
| 2014 | 4,003 |
| 2015 | 2,161 |
| 2016 | 1,931 |
| 2017 and thereafter | 3,113 |
| Total minimum lease payments | $24,032 |

Purchase Commitments. KLA-Tencor maintains certain open inventory purchase commitments with its suppliers to ensure a smooth and continuous supply for key components. The Company’s liability under these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecasted time-horizon can vary among different suppliers. The Company’s open inventory purchase commitments were approximately $337.6 million as of September 30, 2011 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 be less in the event that the arrangements are renegotiated or canceled. Certain agreements provide for potential cancellation penalties.

Guarantees. KLA-Tencor provides standard warranty coverage on its systems for 40 hours per week for twelve months, providing labor and parts necessary to repair the systems during the warranty period. The Company accounts for the estimated warranty cost as a charge to costs of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. Utilizing actual service records, the Company calculates the average service hours and parts expense per system and applies the actual labor and overhead rates to determine the estimated warranty charge. The Company updates these estimated charges on a quarterly basis. The actual product performance and/or field expense profiles may differ, and in those cases the Company adjusts its warranty accruals accordingly.

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The following table provides the changes in the product warranty accrual for the three months ended September 30, 2011 and 2010:

| (In thousands) | Three months ended September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Beginning balance | $41,528 | $21,109 |
| Accruals for warranties issued during the period | 11,292 | 9,486 |
| Changes in liability related to pre-existing warranties | 2,390 | 159 |
| Settlements made during the period | (11,607) | (5,198) |
| Ending balance | $43,603 | $25,556 |

The Company maintains guarantee arrangements available through various financial institutions for up to $20.8 million, of which $18.7 million had been issued as of September 30, 2011, primarily to fund guarantees to customs authorities for VAT and other operating requirements of the Company’s subsidiaries in Europe and Asia.

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, or provides customers with other remedies to protect against, bodily injury or damage to personal property caused by the Company's products, non-compliance with the Company's product performance specifications, infringement by the Company's products of third-party intellectual property rights and 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.

Subject to certain limitations, the Company is obligated to indemnify its current and former directors, officers and employees with respect to certain litigation matters and investigations that arise in connection with their service to the Company. These obligations arise under the terms of its 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.

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.

NOTE 14 – 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 and option contracts as cash flow hedges of certain forecasted foreign currency denominated sales and purchase transactions.

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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 option contracts 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 counterparty 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 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 Company uses 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.
Derivatives in Cash Flow Hedging Relationships: Foreign Exchange Contracts
The location and amounts of designated and non-designated derivative instruments' gains and losses reported in the condensed consolidated financial statements for the three months ended September 30, 2011 and 2010 are as follows:

| (In thousands) | Location in Financial Statements | Three months ended September 30, 2011 | 2010 |
|---|---|---|---|
| Derivatives Designated as Hedging Instruments | | | |
| Gains (losses) in accumulated OCI on derivatives (effective portion) | Accumulated OCI | $(1,194) | $414 |
| Gains (losses) reclassified from accumulated OCI into income (effective portion): | Revenues | $(284) | $(793) |
| | Costs of revenues | 61 | (142) |
| | Total losses reclassified from accumulated OCI into income (effective portion) | $(223) | $(935) |
| Gains (losses) recognized in income on derivatives (ineffective portion and amount excluded from effectiveness testing) | Interest income and other, net | $43 | $(119) |
| Derivatives Not Designated as Hedging Instruments | | | |
| Losses recognized in income | Interest income and other, net | $(12,568) | $(1,356) |

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The U.S. dollar equivalent of all outstanding notional amounts of hedge contracts, with maximum maturity of 13 months, as of September 30, 2011 and June 30, 2011 was as follows:

| (In thousands) | As of September 30, 2011 | As of June 30, 2011 |
|---|---|---|
| Cash flow hedge contracts | | |
| Purchase | $3,222 | $3,381 |
| Sell | $54,855 | $30,133 |
| Other foreign currency hedge contracts | | |
| Purchase | $117,439 | $174,499 |
| Sell | $171,968 | $216,738 |

The location and fair value amounts of the Company’s derivative instruments reported in its Condensed Consolidated Balance Sheets as of September 30, 2011 and June 30, 2011 were as follows:

| | Asset Derivatives | | | Liability Derivatives | | |
|---|---|---|---|---|---|---|
| | Balance Sheet Location | September 30, 2011 | June 30, 2011 | Balance Sheet Location | September 30, 2011 | June 30, 2011 |
| (In thousands) | | Fair Value | | | Fair Value | |
| Derivatives designated as hedging instruments | | | | | | |
| Foreign exchange contracts | Other current assets | $161 | $145 | Other current liabilities | $721 | $475 |
| Total derivatives designated as hedging instruments | | $161 | $145 | | $721 | $475 |
| Derivatives not designated as hedging instruments | | | | | | |
| Foreign exchange contracts | Other current assets | $684 | $1,825 | Other current liabilities | $5,333 | $1,652 |
| Total derivatives not designated as hedging instruments | | $684 | $1,825 | | $5,333 | $1,652 |
| Total derivatives | | $845 | $1,970 | | $6,054 | $2,127 |

The following table provides the balances and changes in the accumulated other comprehensive income (loss) related to derivative instruments for the three months ended September 30, 2011 and 2010:

| | Three months ended September 30, | |
|---|---|---|
| (In thousands) | 2011 | 2010 |
| Beginning balance | $12 | $(1,995) |
| Amount reclassified to income | 223 | 935 |
| Net change | (1,194) | 414 |
| Ending balance | $(959) | $(646) |

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NOTE 15 – RELATED PARTY TRANSACTIONS

During the three months ended September 30, 2011 and 2010, the Company purchased from, or sold to, several entities, where one or more executive officers of the Company or 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 and Cisco Systems, Inc. For the three months ended September 30, 2011 and 2010, 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 September 30, | |
|---|---|---|
| | 2011 | 2010 |
| Total revenues | $37 | $200 |
| Total purchases | $2,092 | $882 |

The Company's receivable balance from these parties was immaterial as of September 30, 2011 and was $0.2 million as of June 30, 2011. Management believes that such transactions are at arm's length and on similar terms as would have been obtained from unaffiliated third parties.

NOTE 16 – 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.

The Company 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 the Company operates in one segment, all financial segment information required by the authoritative guidance can be found in the condensed consolidated financial statements.

The Company'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 regions. 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 months ended September 30, 2011 and 2010 (as a percentage of total revenues):

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | | | 2010 | | |
|---|---|---|---|---|---|---|
| Revenues: | | | | | | |
| United States | $198,243 | 25 | % | $86,519 | 12 | % |
| Taiwan | 223,289 | 28 | % | 188,541 | 28 | % |
| Japan | 134,815 | 17 | % | 93,888 | 14 | % |
| Europe & Israel | 92,996 | 12 | % | 39,246 | 6 | % |
| Korea | 79,598 | 10 | % | 162,091 | 24 | % |
| Rest of Asia | 67,535 | 8 | % | 112,057 | 16 | % |
| Total | $796,476 | 100 | % | $682,342 | 100 | % |

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The following is a summary of revenues by major products for the three months ended September 30, 2011 and 2010 (as a percentage of total revenues):

| | Three months ended September 30, | | | | | |
|---|---|---|---|---|---|---|
| (Dollar amounts in thousands) | 2011 | | | 2010 | | |
| Revenues: | | | | | | |
| Defect inspection | $443,633 | 56 | % | $410,113 | 60 | % |
| Metrology | 182,012 | 23 | % | 119,554 | 18 | % |
| Service | 146,220 | 18 | % | 131,733 | 19 | % |
| Other | 24,611 | 3 | % | 20,942 | 3 | % |
| Total | $796,476 | 100 | % | $682,342 | 100 | % |

Two customers each accounted for greater than 10% of total revenues for the three months ended September 30, 2011 and 2010. Two customers each accounted for greater than 10% of net accounts receivable as of September 30, 2011 and June 30, 2011.

Long-lived assets by geographic region as of September 30, 2011 and June 30, 2011 were as follows:

| (In thousands) | September 30, 2011 | June 30, 2011 |
|---|---|---|
| Long-lived assets: | | |
| United States | $205,763 | $202,520 |
| Taiwan | 838 | 803 |
| Japan | 4,265 | 4,256 |
| Europe & Israel | 87,298 | 90,163 |
| Korea | 2,648 | 2,804 |
| Rest of Asia | 51,463 | 53,106 |
| Total | $352,275 | $353,652 |

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## 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,” “predict “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; 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 maintain cost discipline; 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, 2011, filed with the Securities and Exchange Commission on August 5, 2011. 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.

### EXECUTIVE SUMMARY

KLA-Tencor Corporation is a leading supplier of process control and yield management solutions for the semiconductor and related nanoelectronics industries. Our broad portfolio of products and services primarily supports integrated circuit (“IC” or “chip”) manufacturers throughout the semiconductor fabrication process, from research and development to final volume production. We provide leading-edge equipment, software and support that enable IC manufacturers to identify, resolve and manage significant advanced technology manufacturing process challenges and obtain higher finished product yields at lower overall cost. In addition to serving the semiconductor industry, we also provide a range of technology solutions to a number of other high technology industries, including the light emitting diode (“LED”), data storage and photovoltaic industries, as well as general materials research.

Our products and services are used by the vast majority of bare wafer, IC, lithography reticle ("reticle" or "mask") and disk manufacturers in the world. Our equipment, services and expertise are used by our customers to measure and control nanometric-level manufacturing processes, and to detect, analyze and resolve critical product defects that arise in that environment. Our revenues are driven largely by our customers' spending on capital equipment and related maintenance services necessary to support key transitions in their underlying product technologies, or to increase their production volumes in response to market demand. Our semiconductor customers generally operate in one or more of

the three major semiconductor markets -- memory, foundry and logic. All three of these markets are characterized by rapid technological changes and sudden shifts in end-user demand, which influence the level and pattern of our customers' spending on our products and services. Although capital spending in all three semiconductor markets has historically been very cyclical, the demand for more advanced and lower cost chips used in a growing number of consumer electronics, communications, data processing, and industrial products has resulted in favorable long-term revenue growth rates for our process control and yield management solutions.

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As a supplier to the global semiconductor and semiconductor-related industries, we are subject to the cyclical capital spending that characterizes these industries. The timing, length and volatility of capacity-oriented capital spending cycles of our customers are unpredictable. In addition, our customer base continues to become more highly concentrated over time, thereby increasing the potential impact of a sudden change in capital spending by a major customer on our revenues and profitability.

The growing use of increasingly sophisticated semiconductor devices in communications, consumer electronics, data processing, and automotive and aerospace products, combined with a somewhat improved economic environment, particularly in Asia, caused many of our customers to invest in additional semiconductor manufacturing capabilities and capacity during the fiscal year ended June 30, 2011. These investments included process control and yield management equipment and services, which had a significant favorable impact on our revenues, compared to the prior fiscal year.

During the three months ended September 30, 2011, our customers reduced their purchases of process control and yield management equipment, which will result in lower levels of total revenues until market conditions improve and demand for our products recovers. 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 to reduce cost. We expect that this in turn will drive long term increased adoption of process control equipment and services that reduce semiconductor defectivity and improve manufacturing yields, leaving the longer term drivers underlying growth in our industry intact.

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

| | Three months ended | | | | |
|---|---|---|---|---|---|
| (In thousands, except net income per share) | September 30, 2011 | June 30, 2011 | March 31, 2011 | December 31, 2010 | September 30, 2010 |
| Total revenues | $796,476 | $892,439 | $834,059 | $ 766,327 | $ 682,342 |
| Total costs and operating expenses | $542,187 | $548,370 | $522,280 | $ 497,461 | $ 446,726 |
| Gross margin | $456,127 | $536,259 | $506,363 | $ 454,929 | $ 418,373 |
| Income from operations | $254,289 | $344,069 | $311,779 | $ 268,866 | $ 235,616 |
| Net income | $191,995 | $245,017 | $209,783 | $ 185,492 | $ 154,196 |
| Net income per share: | | | | | |
| Basic (1) | $1.15 | $1.46 | $1.25 | $ 1.11 | $ 0.92 |
| Diluted (1) | $1.13 | $1.43 | $1.22 | $ 1.09 | $ 0.91 |

(1) Basic and diluted earnings per share are computed independently for each of the quarters presented based on the weighted average basic and fully diluted shares outstanding for each quarter. Therefore, the sum of quarterly basic and diluted per share information may not equal annual basic and diluted earnings per share.

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## 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, 2011 describes the significant accounting policies and methods used in preparation of the Consolidated Financial Statements. We base 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. 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 our 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
- Inventories
- Warranty
- Allowance for Doubtful Accounts
- Stock-Based Compensation
- Contingencies and Litigation
- Goodwill and Intangible Assets
- Income Taxes

There were no significant changes in our critical accounting estimates and policies during the three months ended September 30, 2011. 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, 2011 for a more complete discussion of our critical accounting policies and estimates.

### 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. 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 next annual evaluation of the goodwill by reporting unit will be performed during the three months ending December 31, 2011. If we were to encounter challenging economic conditions, such as a decline in our operating results, an unfavorable industry or macroeconomic environment, a substantial decline in our stock price, or any other adverse change in market conditions, particularly if such conditions have the effect of changing one of the critical assumptions or estimates we use to calculate the value of our goodwill or intangible assets, we may be required to record goodwill and/or intangible asset impairment charges in future periods, whether in connection with our next annual impairment testing in the second quarter of fiscal year 2012 or subsequent to that, if any triggering event occurs outside of the quarter during which the annual goodwill impairment test is performed. It is not possible at this time to determine if any such future impairment charge would result or, if it does, whether such charge would be material.

### Revenue Recognition

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the selling price is fixed or determinable, and collectability is reasonably assured. We enter into arrangements that may consist of multiple deliverables of our products and services where certain elements of the sales arrangement are not delivered and accepted in one reporting period. Judgment is required to properly identify the accounting units of the multiple deliverable transactions and to determine the manner in which revenue should be allocated among the accounting units. Additionally, judgment is required to interpret various commercial terms and to determine when all criteria of revenue recognition have been met in order for revenue recognition to occur in the appropriate accounting period. While changes in the allocation of the estimated sales price between the accounting

units will not affect the amount of total revenue recognized for a particular arrangement, any material changes in these allocations could impact the timing of revenue recognition, which could have a material effect on our financial position and results of operations.

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Recent Accounting Pronouncements

In September 2011, the FASB amended its guidance through the issuance of a revised accounting standard intended to simplify testing goodwill for impairment. The amendments allow an entity to first assess qualitative factors to determine whether it is necessary to perform the two-step quantitative goodwill impairment test. An entity will no longer be required to calculate the fair value of a reporting unit unless the entity determines, based on a qualitative assessment, that it is more likely than not that the fair value of the reporting unit is less than its carrying amount. Prior to the amendment, entities were required to test goodwill for impairment, on at least an annual basis, by first comparing the fair value of a reporting unit with its carrying amount, including goodwill. If the fair value of a reporting unit is calculated as being less than its carrying amount, then the second step of the quantitative test is to be performed to measure the amount of impairment loss, if any. The amendment becomes effective for annual and interim goodwill impairment tests performed for our fiscal year ending June 30, 2013. Early adoption is permitted. We are currently evaluating the impact of the guidance on our financial position, results of operations and cash flows.

In June 2011, the FASB amended its guidance on the presentation of comprehensive income. Under the amended guidance, an entity has the option to present comprehensive income in either one continuous statement or two consecutive financial statements. A single statement must present the components of net income and total net income, the components of other comprehensive income and total other comprehensive income, and a total for comprehensive income. In a two-statement approach, an entity must present the components of net income and total net income in the first statement. That statement must be immediately followed by a financial statement that presents the components of other comprehensive income, a total for other comprehensive income, and a total for comprehensive income. The option under current guidance that permits the presentation of components of other comprehensive income as part of the statement of changes in stockholders' equity has been eliminated. The amendment becomes effective during the first quarter of our fiscal year ending June 30, 2013. Early adoption is permitted. 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 May 2011, the FASB amended its guidance, to converge fair value measurement and disclosure guidance about fair value measurement under U.S. GAAP with International Financial Reporting Standards ("IFRS"). IFRS is a comprehensive series of accounting standards published by the International Accounting Standards Board. The amendment changes the wording used to describe many of the requirements in U.S. GAAP for measuring fair value and for disclosing information about fair value measurements. For many of the requirements, the FASB does not intend for the amendment to result in a change in the application of the requirements in the current authoritative guidance. The amendment becomes effective prospectively for our interim reporting period ending March 31, 2012. Early application is not permitted. We do not expect the amendment to have a material impact on our 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 was effective for our interim reporting period ended September 30, 2011. The implementation did not have an impact on our 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 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 our interim reporting period ended March 31, 2010. The implementation of that guidance 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 was effective for our interim reporting period ended September 30, 2011, and the implementation of that guidance did not have an impact on our financial position, results of operations or cash flows as it is disclosure-only in nature.

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RESULTS OF OPERATIONS

Revenues and Gross Margin

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | June 30, 2011 | September 30, 2010 | Q1 FY12 vs. Q4 FY11 | | Q1 FY12 vs. Q1 FY11 | |
|---|---|---|---|---|---|---|---|
| Revenues: | | | | | | | |
| Product | $650,256 | $743,702 | $550,609 | $(93,446) | (13)% | $99,647 | 18% |
| Service | 146,220 | 148,737 | 131,733 | (2,517) | (2)% | 14,487 | 11% |
| Total revenues | $796,476 | $892,439 | $682,342 | $(95,963) | (11)% | $114,134 | 17% |
| Costs of revenues | $340,349 | $356,180 | $263,969 | $(15,831) | (4)% | $76,380 | 29% |
| Gross margin percentage | 57% | 60% | 61% | | | | |

Product revenues

Product revenues decreased during the three months ended September 30, 2011 compared to the three months ended June 30, 2011 as a result of the recent slowdown in the industry demand environment, as customers have been re-assessing capacity expansion plans in light of macroeconomic uncertainty. Within our product portfolio, revenues from defect inspection decreased while revenues from metrology increased.

Product revenues increased during the three months ended September 30, 2011 compared to the three months ended September 30, 2010. The revenue levels for the three months ended September 30, 2011 reflect the stage of the industry cycle as we continued to deliver and install products, many of which had been ordered before the recent slowdown in the industry. Alternatively, during the three months ended September 30, 2010 we were in the midst of a period of increasing orders and demand by our customers for advanced technology development as well as capacity-related investments, where many of those orders did not generate revenue until subsequent fiscal periods. Our business is cyclical with respect to the capital equipment procurement practices of semiconductor manufacturers, with revenues impacted by the investment patterns of such manufacturers.

Service revenues

Service revenues are generated from maintenance contracts, as well as billable time and material service calls made to our customers after the expiration of the warranty period. The amount of service revenues is generally a function of the number of post-warranty systems installed at our customers' sites and the utilization of those systems. Service revenues during the three months ended September 30, 2011 decreased slightly compared to the three months ended June 30, 2011 as a result of lower factory utilization by our customers, partially offset by an increase in revenues from maintenance contracts compared to the three months ended June 30, 2011.

Service revenues increased during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 as a result of an increase in the number of post-warranty systems installed at our customers' sites as well as higher factory utilization by our customers.

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Revenues by region

Revenues by region for the periods indicated were as follows:

| (Dollar amounts in thousands) | Three months ended | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | September 30, 2011 | | | June 30, 2011 | | | September 30, 2010 | | |
| United States | $198,243 | 25 | % | $121,246 | 14 | % | $86,519 | 12 | % |
| Taiwan | 223,289 | 28 | % | 178,619 | 20 | % | 188,541 | 28 | % |
| Japan | 134,815 | 17 | % | 180,876 | 20 | % | 93,888 | 14 | % |
| Europe & Israel | 92,996 | 12 | % | 168,429 | 19 | % | 39,246 | 6 | % |
| Korea | 79,598 | 10 | % | 136,538 | 15 | % | 162,091 | 24 | % |
| Rest of Asia | 67,535 | 8 | % | 106,731 | 12 | % | 112,057 | 16 | % |
| Total | $796,476 | 100 | % | $892,439 | 100 | % | $682,342 | 100 | % |

A significant portion of our revenues continues to be generated in Asia, where a substantial portion of the world’s semiconductor manufacturing capacity is located, and we expect that trend to continue.

Gross margin

Our gross margin fluctuates with revenue levels and product mix and is affected by variations in costs related to manufacturing and servicing our products, including our ability to scale our operations efficiently and effectively in response to prevailing business conditions. Over the past several years, we have embarked on various advanced product development, customer satisfaction improvement and globalization initiatives to improve our competitiveness and gross margins.

The following tables summarize the major factors that contributed to the changes in gross margin percentage:

| | Gross Margin Percentage Three months ended | | | Gross Margin Percentage Three months ended | |
|---|---|---|---|---|---|
| June 30, 2011 | 60.1 | % | September 30, 2010 | 61.3 | % |
| Revenue volume of products and service | (1.0 | )% | Revenue volume of products and service | (0.6 | )% |
| Mix of products and services sold | 0.1 | % | Mix of products and services sold | (0.6 | )% |
| Manufacturing labor, overhead and efficiencies | (0.7 | )% | Manufacturing labor, overhead and efficiencies | 0.1 | % |
| Other service and manufacturing costs | (1.2 | )% | Other service and manufacturing costs | (2.9 | )% |
| September 30, 2011 | 57.3 | % | September 30, 2011 | 57.3 | % |

Changes in gross margin percentage driven by revenue volume reflect our ability to leverage existing infrastructure to generate higher revenues. It also includes the effect of fluctuations in foreign exchange rates and average customer pricing. Changes in gross margin percentage from mix of products and services sold reflect the impact of changes in the composition within product and service offerings, as well as differences in transaction-specific revenue realization. Changes in gross margin percentage from manufacturing labor, overhead and efficiencies reflect our ability to manage costs and drive productivity as we scale our manufacturing activity to respond to customer requirements; this includes the impact of capacity utilization, use of overtime and variability of cost structure. Changes in gross margin percentage from other service and manufacturing costs include the impact of customer support costs, including the efficiencies with which we deliver services to our customers, and the effectiveness with which we manage our production plans and inventory risk.

Our gross margin declined to 57.3% during the three months ended September 30, 2011 from 60.1% during the three months ended June 30, 2011 primarily due to lower revenue volume, higher inventory reserves (due to a decrease in anticipated demand) and higher customer support costs.

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Our gross margin declined to 57.3% during the three months ended September 30, 2011 from 61.3% during the three months ended September 30, 2010 primarily due to higher inventory reserves (due to a decrease in anticipated demand) and higher customer support costs.

Engineering, Research and Development (“R&D”)

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | June 30, 2011 | September 30, 2010 | Q1 FY12 vs. Q4 FY11 | | Q1 FY12 vs. Q1 FY11 | |
|---|---|---|---|---|---|---|---|
| R&D expenses | $107,762 | $100,929 | $94,720 | $6,833 | 7 % | $13,042 | 14 % |
| R&D expenses as a percentage of total revenues | 14 % | 11 % | 14 % | | | | |

R&D expenses during the three months ended September 30, 2011 increased compared to the three months ended June 30, 2011, primarily due to an increase in employee-related expenses of $2.5 million as we employed additional engineers to support program development related to our next generation products, and a decrease in external R&D funding of $2.6 million.

R&D expenses during the three months ended September 30, 2011 increased compared to the three months ended September 30, 2010, primarily due to an increase in employee-related expenses of $7.4 million as a result of additional engineering headcount, an increase in engineering material costs of $3.5 million and an increase in external services of $2.4 million to support expanded R&D activities, partially offset by an increase of $0.8 million in external R&D funding.

R&D expenses include the benefit of $3.6 million, $6.2 million and $2.8 million of external funding received during the three months ended September 30, 2011, June 30, 2011 and September 30, 2010, respectively, for certain strategic development programs from government grants.

Our future operating results will depend significantly on our ability to produce products and provide services that have a competitive advantage in our marketplace. To do this, we believe that we must continue to make substantial investments in our research and development. We remain committed to product development in new and emerging technologies as we address the yield challenges our customers face at future technology nodes.

Selling, General and Administrative (“SG&A”)

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | June 30, 2011 | September 30, 2010 | Q1 FY12 vs. Q4 FY11 | | Q1 FY12 vs. Q1 FY11 | |
|---|---|---|---|---|---|---|---|
| SG&A expenses | $94,076 | $91,261 | $88,037 | $2,815 | 3 % | $6,039 | 7 % |
| SG&A expenses as a percentage of total revenues | 12 % | 10 % | 13 % | | | | |

SG&A expenses during the three months ended September 30, 2011 increased compared to the three months ended June 30, 2011, primarily due to $9.6 million of bad debt recovery that was recorded in the three months ended June 30, 2011 compared to no such recovery during the three months ended September 30, 2011 and an increase of $1.1 million in consulting expenses, partially offset by a decrease of $3.0 million in legal expenses and a decrease of $5.2 million in employee-related expenses as a result of lower variable compensation expenses even though headcount is higher compared to the three months ended June 30, 2011.

SG&A expenses during the three months ended September 30, 2011 increased compared to the three months ended September 30, 2010, primarily due to an increase of $2.5 million in external services such as consulting and legal and an increase of $2.1 million in facilities expenses.

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Interest Income and Other, Net and Interest Expense

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | June 30, 2011 | September 30, 2010 |
|---|---|---|---|
| Interest income and other, net | $6,866 | $3,871 | $1,225 |
| Interest expense | $13,893 | $13,897 | $13,529 |
| Interest income and other, net as a percentage of total revenues | 1 % | — % | — % |
| Interest expense as a percentage of total revenues | 2 % | 2 % | 2 % |

Interest income and other, net is comprised primarily of interest income earned on our investment and cash portfolio, realized gains or losses on sales of marketable securities, gains or losses from revaluation of certain foreign currency denominated assets and liabilities as well as foreign currency contracts, and impairments associated with equity investments in privately-held companies. The increase in interest income and other, net during the three months ended September 30, 2011 compared to the three months ended June 30, 2011 was primarily due to a decrease of $2.7 million in accrued interest and penalties on uncertain tax positions. The increase in interest income and other, net during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 was primarily attributable to a decrease of $3.9 million in accrued interest and penalties on uncertain tax positions and a decrease of $2.6 million in foreign exchange loss due to the revaluation of certain foreign currency denominated assets and liabilities during the three months ended September 30, 2011.

Interest expense is primarily attributable to the $750 million aggregate principal amount of senior fixed rate notes that we issued in the fourth quarter of the fiscal year ended June 30, 2008.

Provision for Income Taxes

The following table provides details of income taxes:

| (Dollar amounts in thousands) | Three months ended September 30, 2011 | June 30, 2011 | September 30, 2010 |
|---|---|---|---|
| Income before income taxes | $247,262 | $334,043 | $223,312 |
| Provision for taxes | 55,267 | 89,026 | 69,116 |
| Effective tax rate | 22.4 % | 26.7 % | 31.0 % |

Our estimated annual effective tax rate for the fiscal year ending June 30, 2012 is approximately 25.0%.

The difference between the actual effective tax rate of 22.4% during the quarter and the estimated annual effective tax rate of 25.0% is primarily due to the tax impact of the following items during the three months ended September 30, 2011:

- Tax benefit of $18.3 million was recognized related to the settlement of a United States federal income tax examination for the fiscal years ended June 30, 2007 through June 30, 2009. During the three months ended September 30, 2011, we received acceptance from the Joint Committee of Taxation for the settlement of the U.S. federal income tax examination. As a result of the settlement, we reduced our unrecognized tax benefits by $22.0 million.
- Tax benefit of $18.0 million was recognized related to a decrease in reserves for uncertain tax positions taken in prior years.
- Tax expense of $23.6 million was recognized related to an inter-company licensing agreement in connection with the migration of a portion of our manufacturing to Singapore.
- Tax expense of $5.2 million was recognized related to a non-deductible decrease in the value of the assets held within our Executive Deferred Savings Plan.

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Tax expense was lower as a percentage of income during the three months ended September 30, 2011 compared to the three months ended September 30, 2010 primarily due to:

- A tax benefit of $18.3 million recognized during the three months ended September 30, 2011 resulting from a decrease in our unrecognized tax benefits due to the settlement of a U.S. federal income tax examination;
- A tax benefit of $18.0 million recognized during the three months ended September 30, 2011 resulting from a decrease in reserves for uncertain tax positions taken in prior years;
- A decrease in tax expense of $6.9 million during the three months ended September 30, 2011related to state income taxes; and
- A decrease in tax expense of $7.7 million during the three months ended September 30, 2011 related to an increase in the proportion of our earnings generated in jurisdictions with tax rates lower than the U.S. statutory tax rate; partially offset by
- An increase in tax expense of $23.6 million during the three months ended September 30, 2011 related to a migration of a portion of our manufacturing to Singapore.

Tax expense was lower as a percentage of income during the three months ended September 30, 2011 compared to the three months ended June 30, 2011 primarily due to:

- A tax benefit of $18.0 million recognized during the three months ended September 30, 2011 resulting from a decrease in unrecognized tax benefits due to the settlement of a U.S. federal income tax examination;
- A tax benefit of $18.0 million recognized during the three months ended September 30, 2011 resulting from a decrease in reserves for uncertain tax positions taken in prior years; partially offset by
- An increase in tax expense of $23.6 million during the three months ended September 30, 2011 relating to a migration of a portion of our manufacturing to Singapore.

In the normal course of business, we are subject to examination by taxing authorities throughout the world. We are subject to federal income tax examination for all years beginning from the year ended June 30, 2010. We are subject to state income tax examinations for all years beginning from the fiscal year ended June 30, 2007. We are also subject to examinations in other major foreign jurisdictions, including Singapore, for all years beginning from the fiscal year ended June 30, 2007. It is possible that certain examinations may be concluded in the next twelve months. We believe it is possible that we may recognize up to $1.1 million of our existing unrecognized tax benefits within the next twelve months as a result of the lapse of statutes of limitations and the resolution of examinations with various tax authorities.

LIQUIDITY AND CAPITAL RESOURCES

| (Dollar amounts in thousands) | September 30, 2011 | June 30, 2011 |
|---|---|---|
| Cash and cash equivalents | $745,947 | $711,329 |
| Marketable securities | 1,354,204 | 1,327,206 |
| Total cash, cash equivalents and marketable securities | $2,100,151 | $2,038,535 |
| Percentage of total assets | 46 % | 44 % |

| | Three months ended | |
|---|---|---|
| (In thousands) | September 30, 2011 | September 30, 2010 |
| Cash flow: | | |
| Net cash provided by operating activities | $218,985 | $95,528 |
| Net cash provided by (used in) investing activities | (48,708) | 14,155 |
| Net cash used in financing activities | (133,080) | (110,505) |
| Effect of exchange rate changes on cash and cash equivalents | (2,579) | 9,288 |
| Net increase in cash and cash equivalents | $34,618 | $8,466 |

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As of September 30, 2011, our cash, cash equivalents and marketable securities totaled $2.1 billion, which is an increase of $61.6 million from June 30, 2011. As of September 30, 2011, $684.8 million of the $2.1 billion of cash, cash equivalents, and marketable securities were held by our foreign subsidiaries and branch offices. We currently intend to permanently reinvest $455.6 million of the cash held by our foreign subsidiaries. If, however, a portion of these funds were to be needed for our operations in the United States, we would be required to accrue and pay U.S. and foreign taxes of approximately 30%-50% of the funds repatriated. The amount of taxes due will depend on the amount and manner of the repatriation, as well as the location from where the funds are repatriated. We have accrued (but have not paid) U.S. taxes on the remaining cash of $229.2 million of the $684.8 million held by our foreign subsidiaries and branch offices. As such, these funds can be returned to the U.S. without accruing any additional U.S. tax expense.

During the three months ended September 30, 2011, our Board of Directors declared a dividend of $0.35 per share of our outstanding common stock, which was paid on September 1, 2011 to our stockholders on record as of August 15, 2011. During the same period in fiscal year 2011, our Board of Directors declared and paid a quarterly cash dividend of $0.25 per share. The total amount of dividends paid during the three months ended September 30, 2011 and 2010 was $58.5 million and $41.8 million, respectively. The increase in the amount of dividends paid during the three months ended September 30, 2011 reflects the increase in the level of our quarterly dividend from $0.25 to $0.35 per share.

The shares repurchased under our stock repurchase program have decreased our basic and diluted weighted-average shares outstanding. The decrease was partially offset by additional shares issued upon the exercise of employee stock options and the vesting of employee restricted stock units and in connection with stock purchases under our Employee Stock Purchase Plan.

We have historically financed our liquidity requirements through cash generated from operations. Net cash provided by operating activities during the three months ended September 30, 2011 increased compared to the three months ended September 30, 2010 primarily as a result of the following key factors:

- An increase in cash collections of approximately $210 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010, due to higher sales volume, offset by
- An increase in vendor payments of approximately $65 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010, to support a higher level of business activities, and
- An increase in payroll expenses of approximately $40 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010, mainly due to increases in employee headcount.

Net cash used in investing activities during the three months ended September 30, 2011 increased compared to the three months ended September 30, 2010 primarily as a result of an increase in the use of cash for purchases of available-for-sale and trading securities, net of sales and maturities during the three months ended September 30, 2011 compared to the three months ended September 30, 2010.

Net cash used in financing activities during the three months ended September 30, 2011 increased compared to the three months ended September 30, 2010 primarily as a result of the following factors:

- An increase in dividend payments of $16.7 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010, mainly due to an increase in our quarterly dividend from $0.25 to $0.35 per share that was instituted during the three months ended September 30, 2011,
- An increase in tax withholding payments related to vested and released restricted stock units of $8.4 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010, and
- An increase in common stock repurchases of $4.2 million during the three months ended September 30, 2011 compared to the three months ended September 30, 2010, offset by
- An increase in proceeds from the exercise of stock options of $6.8 million during the three months ended September 30, 2011.

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The following is a schedule summarizing our significant obligations to make future payments under contractual obligations as of September 30, 2011:

| | Fiscal year ending June 30, | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| (In thousands) | Total | 2012 (2) | 2013 | 2014 | 2015 | 2016 | Thereafter | Other |
| Long-term debt obligations(1) | $750,000 | $— | $— | $— | $— | $— | $750,000 | $— |
| Interest expense associated with long-term debt obligations | 340,688 | 38,813 | 51,750 | 51,750 | 51,750 | 51,750 | 94,875 | — |
| Purchase commitments | 337,609 | 320,888 | 13,087 | 3,414 | 130 | 90 | — | — |
| Non-current income tax payable(3) | 42,023 | — | — | — | — | — | — | 42,023 |
| Operating leases | 24,032 | 6,430 | 6,394 | 4,003 | 2,161 | 1,931 | 3,113 | — |
| Pension obligations | 27,056 | 1,501 | 1,240 | 2,185 | 2,927 | 2,466 | 16,737 | — |
| Total contractual cash obligations | $1,521,408 | $367,632 | $72,471 | $61,352 | $56,968 | $56,237 | $864,725 | $42,023 |

(1) In April 2008, we issued $750 million aggregate principal amount of senior notes due in 2018.
(2) Remaining 9 months.
(3) Represents the non-current income tax payable obligation. We are unable to make a reasonably reliable estimate of the timing of payments in individual years beyond 12 months due to uncertainties in the timing of tax audit outcomes.

We have agreements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. In addition, from time to time we will discount, without recourse, letters of credit (“LCs”) received from customers in payment of goods.

The following table shows total receivables sold under factoring agreements and proceeds from sales of LCs for the three months ended September 30, 2011 and 2010:

| | Three months ended | |
|---|---|---|
| (In thousands) | September 30, 2011 | September 30, 2010 |
| Receivables sold under factoring agreements | $168,724 | $60,025 |
| Proceeds from sales of LCs | $4,510 | $50,831 |

Factoring and LC fees for the sale of certain trade receivables were recorded in interest income and other, net and were not material for the periods presented.

We maintain guarantee arrangements available through various financial institutions for up to $20.8 million, of which $18.7 million had been issued as of September 30, 2011 primarily to fund guarantees to customs authorities for VAT and other operating requirements of our subsidiaries in Europe and Asia.

We maintain certain open inventory purchase commitments with our suppliers to ensure a smooth and continuous supply for key components. Our liability under these purchase commitments is generally restricted to a forecasted time-horizon as mutually agreed upon between the parties. This forecasted time-horizon can vary among different

suppliers. Our open inventory purchase commitments were approximately $337.6 million as of September 30, 2011, 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 be less in the event that the arrangements are renegotiated or canceled. Certain agreements provide for potential cancellation penalties.

We provide standard warranty coverage on our systems for 40 hours per week for twelve months, providing labor and parts necessary to repair the systems during the warranty period. We account for the estimated warranty cost as a charge to costs of revenues when revenue is recognized. The estimated warranty cost is based on historical product performance and field expenses. The actual product performance and/or field expense profiles may differ, and in those cases we adjust our warranty accruals accordingly. The difference between the estimated and actual warranty costs tends to be larger for new product introductions as there is limited historical product performance to estimate warranty expense; more mature products with longer product performance histories tend to be more stable in our warranty charge estimates. Non-standard warranty coverage generally includes services incremental to the standard 40-hour per week coverage for twelve months. See Note 13, "Commitments and Contingencies," to the Condensed Consolidated Financial Statements for a detailed description.

Working capital increased to $2.9 billion as of September 30, 2011, compared to $2.8 billion as of June 30, 2011. As of September 30, 2011, our principal sources of liquidity consisted of $2.1 billion of cash, cash equivalents, and marketable securities. Our liquidity is affected by many factors, some of which are based on the normal ongoing operations of the business, and others of which relate to the uncertainties of global economies and the semiconductor and the semiconductor equipment industries. Although cash requirements will fluctuate based on the timing and extent of these factors, we believe that cash generated from operations, together with the liquidity provided by existing cash balances, will be sufficient to satisfy our liquidity requirements for at least the next twelve months.

In April 2008, we 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 our ability to grant liens on our facilities and to enter into sale and leaseback transactions, subject to significant allowances under which certain sale and leaseback transactions are not restricted. We were in compliance with all of our covenants as of September 30, 2011.

Our credit ratings and outlooks as of October 10, 2011 are summarized below:

| Rating Agency | Rating | Outlook |
|---|---|---|
| Fitch | BBB | Stable |
| Moody's | Baa1 | Stable |
| Standard & Poor's | BBB | Stable |

Factors that can affect our credit ratings include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position, and changes in our business strategy.

Off-Balance Sheet Arrangements

Under our foreign currency risk management strategy, we utilize derivative instruments to protect our interests from unanticipated fluctuations in earnings and cash flows caused by volatility in currency exchange rates. This financial exposure is monitored and managed as an integral part of our overall risk management program which focuses on the unpredictability of financial markets and seeks to reduce the potentially adverse effects that the volatility of these markets may have on our operating results. We continue our policy of hedging our current and forecasted foreign currency exposures with hedging instruments having tenors of up to 18 months (see Note 14, "Derivative Instruments and Hedging Activities" to the Condensed Consolidated Financial Statements for a detailed description). Our outstanding hedge contracts, with maximum maturity of 18 months, were as follows:

| (In thousands) | As of September 30, 2011 | As of June 30, 2011 |
|---|---|---|
| Cash flow hedge contracts | | |
| Purchase | $3,222 | $3,381 |
| Sell | $54,855 | $30,133 |
| Other foreign currency hedge contracts | | |

| | | |
|---|---|---|
| Purchase | $117,439 | $174,499 |
| Sell | $171,968 | $216,738 |

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Indemnification Obligations. Subject to certain limitations, we are obligated to indemnify our current and former directors, officers and employees with respect to certain litigation matters and investigations that arise in connection with their service to us. These obligations arise under the terms of our certificate of incorporation, our bylaws, applicable contracts, and Delaware and California law. The obligation to indemnify generally means that we are required to pay or reimburse the individuals’ reasonable legal expenses and possibly damages and other liabilities incurred in connection with these matters. We paid or reimbursed legal expenses incurred in connection with the investigation of our historical stock option practices and the related litigation and government inquiries by a number of our current and former directors, officers and employees. We are currently paying defense costs to one former officer and employee facing an SEC civil action to which we are not a party. Although the maximum potential amount of future payments we could be required to make under these agreements is theoretically unlimited, we believe the fair value of this liability, to the extent estimable, is appropriately considered within the reserve we have established for currently pending legal proceedings.

We are a party to a variety of agreements pursuant to which we 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 we customarily agree to hold the other party harmless against losses arising from, or provide customers with other remedies to protect against, bodily injury or damage to personal property caused by our products, non-compliance with our product performance specifications, infringement by our products of third-party intellectual property rights and 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 us is typically subject to the other party making a claim to and cooperating with us pursuant to the procedures specified in the particular contract. This usually allows us 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, our obligations under these agreements may be limited in terms of amounts, activity (typically at our option to replace or correct the products or terminate the agreement with a refund to the other party), and duration. In some instances, we may have recourse against third parties and/or insurance covering certain payments made by us.

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

## ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and marketable equity security prices. To mitigate these risks, we utilize derivative financial instruments, such as foreign currency hedges. We do not use derivative financial instruments for speculative or trading purposes. All of the potential changes noted below are based on sensitivity analyses performed on our financial position as of September 30, 2011. Actual results may differ materially.

As of September 30, 2011, we had an investment portfolio of fixed income securities of $1.3 billion, excluding those classified as cash and cash equivalents. These securities, as with all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels as of September 30, 2011, the fair value of the portfolio would have declined by $1.5 million.

As of September 30, 2011, we had net forward and option contracts to sell $106.2 million in foreign currency in order to hedge certain currency exposures (see Note 14, “Derivative Instruments and Hedging Activities,” to the Condensed Consolidated Financial Statements for a detailed description). If we had entered into these contracts on September 30, 2011, the U.S. dollar equivalent would have been $111.4 million. A 10% adverse move in all currency exchange rates affecting the contracts would decrease the fair value of the contracts by $23.8 million. However, if this occurred, the fair value of the underlying exposures hedged by the contracts would increase by a similar amount. Accordingly, we believe that the hedging of our foreign currency exposure should have no material impact on net income or cash flows.

In April 2008, we issued $750 million aggregate principal amount of 6.90% senior unsecured notes due in 2018. The fair market value of long-term fixed interest rate debt is subject to interest rate risk. Generally, the fair market value of fixed interest rate debt will increase as interest rates fall and decrease as interest rates rise. As of September 30, 2011, the book value and the fair value of our fixed rate debt were $746.4 million and $857.4 million, respectively.

See Note 4, “Marketable Securities,” to the Condensed Consolidated Financial Statements in Part I, Item 1; Management’s Discussion and Analysis of Financial Condition and Results of Operations, “Liquidity and Capital Resources,” in Part I, Item 2; and Risk Factors in Part II, Item 1A of this Quarterly Report on Form 10-Q for a description of recent market events that may affect the value of the investments in our portfolio that we held as of September 30, 2011.

## ITEM 4 CONTROLS AND PROCEDURES

### Evaluation of Disclosure Controls and Procedures and Related CEO and CFO Certifications

### Evaluation of Disclosure Controls and Procedures

The Company conducted an evaluation of the effectiveness of the design and operation of its disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) (“Disclosure Controls”) as of the end of the period covered by this Quarterly Report on Form 10-Q (this “Report”) required by Exchange Act Rules 13a-15(b) or 15d-15(b). The controls evaluation was conducted under the supervision and with the participation of the Company’s management, including the Company’s Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”). Based on this evaluation, the CEO and CFO have concluded that as of the end of the period covered by this Report the Company’s Disclosure Controls were effective at a reasonable assurance level.

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

### Definition of Disclosure Controls

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

### Limitations on the Effectiveness of Controls

The Company’s management, including the CEO and CFO, does not expect that the Company’s Disclosure Controls or internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the Company have been detected. These inherent limitations include the realities that judgments in decision making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

### Changes in Internal Control over Financial Reporting

There were no changes in the Company's internal control over financial reporting during the three months ended September 30, 2011 that have materially affected, or are reasonably likely to materially affect, the Company's internal

control over financial reporting.



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PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth above under Note 12, “Litigation and Other Legal Matters,” to the Condensed Consolidated Financial Statements in Item 1 of Part 1 is incorporated herein by reference.

ITEM 1A. RISK FACTORS

A description of factors that could materially affect our business, financial condition or operating results is provided below.

Risks Associated with Our Industry

The semiconductor equipment industry is highly cyclical. The purchasing decisions of our customers are highly dependent on the economies of both the local markets in which they are located and the semiconductor industry worldwide. If we fail to respond to industry cycles, our business could be seriously harmed.

The timing, length and severity of the up-and-down cycles in the semiconductor equipment industry are difficult to predict. The cyclical nature of the primary industry in which we operate is largely a function of our customers’ capital spending patterns and need for expanded manufacturing capacity, which in turn are affected by factors such as capacity utilization, consumer demand for products, inventory levels and our customers’ access to capital. This cyclicality affects our ability to accurately predict future revenue and, in some cases, future expense levels. During down cycles in our industry, the financial results of our customers may be negatively impacted, which could result not only in a decrease in, or cancellation or delay of, orders (which are generally subject to cancellation or delay by the customer with limited or no penalty) but also a weakening of their financial condition that could impair their ability to pay for our products or our ability to recognize revenue from certain customers. Our ability to recognize revenue from a particular customer may also be negatively impacted by the customer's funding status, which could be weakened not only by adverse business conditions or inaccessibility to capital markets for any number of macroeconomic or company-specific reasons, but also by funding limitations imposed by the customer's unique corporate structure. Any of these factors could negatively impact our business, operating results and financial condition.

When cyclical fluctuations result in lower than expected revenue levels, operating results may be adversely affected and cost reduction measures may be necessary in order for us to remain competitive and financially sound. During periods of declining revenues, as was experienced during fiscal year 2009, we must be in a position to adjust our cost and expense structure to prevailing market conditions and to continue to motivate and retain our key employees. If we fail to respond, or if our attempts to respond fail to accomplish our intended results, then our business could be seriously harmed. Furthermore, any workforce reductions and cost reduction actions that we adopt in response to down cycles may result in additional restructuring charges, disruptions in our operations and loss of key personnel. In addition, during periods of rapid growth, we must be able to increase manufacturing capacity and personnel to meet customer demand. We can provide no assurance that these objectives can be met in a timely manner in response to industry cycles. Each of these factors could adversely impact our operating results and financial condition.

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In addition, our management typically provides quarterly forecasts for certain financial metrics, which, when made, are based on business and operational forecasts that are believed to be reasonable at the time. However, largely due to the cyclicality of our business and the industries in which we operate, and the fact that business conditions in our industries can change very rapidly as part of these cycles, our actual results may vary (and have varied in the past) from forecasted results. These variations can occur for any number of reasons, including, but not limited to, unexpected changes in the volume or timing of customer orders, product shipments or product acceptances; an inability to adjust our operations rapidly enough to changing business conditions; or a different than anticipated effective tax rate. The impact on our business of delays or cancellations of customer orders may be exacerbated by the short lead times that our customers expect between order placement and product shipment. This is because order delays and cancellations may lead not only to lower revenues, but also, due to the advance work we must do in anticipation of receiving a product order in order to meet the expected lead times, to significant inventory write-offs and manufacturing inefficiencies that decrease our gross margin. Any of these factors could materially and adversely affect our financial results for a particular quarter and could cause those results to differ materially from financial forecasts we have previously provided. We provide these forecasts with the intent of giving investors and analysts a better understanding of management's expectations for the future, but parties reviewing such forecasts must recognize that such forecasts are comprised of, and are themselves, forward-looking statements subject to the risks and uncertainties described in this Item 1A and elsewhere in this report and in our other public filings and public statements. If our operating or financial results for a particular period differ from our forecasts or the expectations of investment analysts, or if we revise our forecasts, the market price of our common stock could decline.

Ongoing changes in the technology industry, as well as the semiconductor industry in particular, could expose our business to significant risks.

The semiconductor equipment industry and other industries that we serve are constantly developing and changing over time. Many of the risks associated with operating in these industries are comparable to the risks faced by all technology companies, such as the uncertainty of future growth rates in the industries that we serve, pricing trends in the end-markets for consumer electronics and other products (which place a growing emphasis on our customers' cost of ownership), changes in our customers' capital spending patterns and, in general, an environment of constant change and development, including decreasing product and component dimensions; use of new materials; and increasingly complex device structures, applications and process steps. If we fail to appropriately adjust our cost structure and operations to adapt to any of these trends, or, with respect to technological advances, if we do not timely develop new technologies and products that successfully anticipate and address these changes, we could experience a material adverse effect on our business, financial condition and operating results.

In addition, we face a number of risks specific to ongoing changes in the semiconductor industry, as the significant majority of our sales are made to semiconductor manufacturers. Some of the trends that our management monitors in operating our business include the following:

- the increasing cost of building and operating fabrication facilities and the impact of such increases on our customers' investment decisions;
- differing market growth rates and capital requirements for different applications, such as memory, logic and foundry;
- the emergence of disruptive technologies that change the prevailing semiconductor manufacturing processes (or the economics associated with semiconductor manufacturing) and, as a result, also impact the inspection and metrology requirements associated with such processes;
- the possible introduction of integrated products by our larger competitors that offer inspection and metrology functionality in addition to managing other semiconductor manufacturing processes;
- changes in semiconductor manufacturing processes that are extremely costly for our customers to implement and, accordingly, impact the amount of their budgets that are available for process control equipment;
- the bifurcation of the semiconductor manufacturing industry into (a) leading edge manufacturers driving continued research and development into next-generation products and technologies and (b) other manufacturers that are content with existing (including previous generation) products and technologies;
- the ever escalating cost of next-generation product development, which may result in joint development programs between us and our customers to help fund such programs that could restrict our control of, ownership of and

profitability from the products and technologies developed through those programs;

- the potential industry transition from 300mm to 450mm wafers; and
- the entry by some semiconductor manufacturers into collaboration or sharing arrangements for capacity, cost or risk with other manufacturers, as well as increased outsourcing of their manufacturing activities, and greater focus only on specific markets or applications, whether in response to adverse market conditions or other market pressures.

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Any of the changes described above may negatively affect our customers' rate of investment in the capital equipment that we produce, which could result in downward pressure on our prices, customer orders, revenues and gross margins. If we do not successfully manage the risks resulting from any of these or other potential changes in our industries, our business, financial condition and operating results could be adversely impacted.

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

Our customer base, particularly in the semiconductor industry, historically has been, and is becoming increasingly, highly concentrated. In this environment, orders from a relatively limited number of manufacturers have accounted for, and are expected to continue to account for, a substantial portion of our sales. In addition, the mix and type of customers, and sales to any single customer, may vary significantly from quarter to quarter and from year to year. If customers do not place orders, or they delay or cancel orders, we may not be able to replace the business. Furthermore, because our products are configured to customer specifications, any changes, delays or cancellations of orders may result in significant, non-recoverable costs. As a result of the consolidation within our customer base, the customers that survive that consolidation represent a greater portion of our sales. Those surviving customers may have more aggressive policies regarding engaging alternative, second-source suppliers for the products we serve and, in addition, may seek, and on occasion receive, pricing, payment, intellectual property-related, or other commercial terms that are less favorable to us. Any of these changes could negatively impact our prices, customer orders, revenues and gross margins. Also, certain customers have undergone significant ownership changes, experienced management changes or have outsourced manufacturing activities, any of which may result in additional complexities in managing customer relationships and transactions. As a result of the challenging economic environment during fiscal year 2009, we were (and in some cases continue to be) exposed to additional risks related to the continued financial viability of certain of our customers. To the extent our customers experience liquidity issues in the future, we may be required to incur additional bad debt expense with respect to receivables owed to us by those customers. In addition, customers with liquidity issues may be forced to discontinue operations or may be acquired by one of our customers, and in either case such event would have the effect of further consolidating our customer base. Any of these factors could have a material adverse effect on our business, financial condition and operating results.

Risks Related to Our Business Model and Capital Structure

If we do not develop and introduce new products and technologies in a timely manner in response to changing market conditions or customer requirements, our business could be seriously harmed.

Success in the semiconductor equipment industry depends, in part, on continual improvement of existing technologies and rapid innovation of new solutions. For example, the size of semiconductor devices continues to shrink, and the industry is currently transitioning to the use of new materials and innovative fab processes. While we expect these trends will increase our customers' reliance on diagnostic products such as ours, we cannot be sure that these trends will directly improve our business. These and other evolving customer needs require us to respond with continued development programs and to cut back or discontinue older programs, which may no longer have industry-wide support. Technical innovations are inherently complex and require long development cycles and appropriate staffing of highly qualified employees. Our competitive advantage and future business success depend on our ability to accurately predict evolving industry standards, to develop and introduce new products that successfully address changing customer needs, to win market acceptance of these new products and to manufacture these new products in a timely and cost-effective manner.

In this environment, we must continue to make significant investments in research and development in order to enhance the performance, features and functionality of our products, to keep pace with competitive products and to satisfy customer demands. Substantial research and development costs typically are incurred before we confirm the technical feasibility and commercial viability of a new product, and not all development activities result in commercially viable products. There can be no assurance that revenues from future products or product enhancements will be sufficient to recover the development costs associated with such products or enhancements. In addition, we cannot be sure that these products or enhancements will receive market acceptance or that we will be able to sell these products at prices that are favorable to us. Our business will be seriously harmed if we are unable to sell our products at favorable prices or if the market in which we operate does not accept our products.

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In addition, the complexity of our products exposes us to other risks. We regularly recognize revenue from a sale upon shipment of the applicable product to the customer (even before receiving the customer's formal acceptance of that product) in certain situations, including sales of products for which installation is considered perfunctory, transactions in which the product is sold to an independent distributor and we have no installation obligations, and sales of products where we have previously delivered the same product to the same customer location and that prior delivery has been accepted. However, our products are very technologically complex and rely on the interconnection of numerous subcomponents (all of which must perform to their respective specifications), so it is conceivable that a product for which we recognize revenue upon shipment may ultimately fail to meet the overall product's required specifications. In such a situation, the customer may be entitled to certain remedies, which could materially and adversely affect our operating results for various periods and, as a result, our stock price.

Our success is dependent in part on our technology and other proprietary rights. If we are unable to maintain our lead or protect our proprietary technology, we may lose valuable assets.

Our success is dependent in part on our technology and other proprietary rights. We own various United States and international patents and have additional pending patent applications relating to some of our products and technologies. The process of seeking patent protection is lengthy and expensive, and we cannot be certain that pending or future applications will actually result in issued patents or that issued patents will be of sufficient scope or strength to provide meaningful protection or commercial advantage to us. Other companies and individuals, including our larger competitors, may develop technologies and obtain patents relating to our business that are similar or superior to our technology or may design around the patents we own, adversely affecting our business. In addition, we at times engage in collaborative technology development efforts with our customers and suppliers, and these collaborations may constitute a key component of certain of our ongoing technology and product research and development projects. The termination of any such collaboration, or delays caused by disputes or other unanticipated challenges that may arise in connection with any such collaboration, could significantly impair our research and development efforts, which could have a material adverse impact on our business and operations.

We also maintain trademarks on certain of our products and services and claim copyright protection for certain proprietary software and documentation. However, we can give no assurance that our trademarks and copyrights will be upheld or successfully deter infringement by third parties.

While patent, copyright and trademark protection for our intellectual property is important, we believe our future success in highly dynamic markets is most dependent upon the technical competence and creative skills of our personnel. We attempt to protect our trade secrets and other proprietary information through confidentiality and other agreements with our customers, suppliers, employees and consultants and through other security measures. We also maintain exclusive and non-exclusive licenses with third parties for strategic technology used in certain products. However, these employees, consultants and third parties may breach these agreements, and we may not have adequate remedies for wrongdoing. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as do the laws of the United States. In any event, the extent to which we can protect our trade secrets through the use of confidentiality agreements is limited, and our success will depend to a significant extent on our ability to innovate ahead of our competitors.

Our future performance depends, in part, upon our ability to continue to compete successfully worldwide.

Our industry includes large manufacturers with substantial resources to support customers worldwide. Some of our competitors are diversified companies with greater financial resources and more extensive research, engineering, manufacturing, marketing, and customer service and support capabilities than we possess. We face competition from companies whose strategy is to provide a broad array of products and services, some of which compete with the products and services that we offer. These competitors may bundle their products in a manner that may discourage customers from purchasing our products, including pricing such competitive tools significantly below our product offerings. In addition, we face competition from smaller emerging semiconductor equipment companies whose strategy is to provide a portion of the products and services that we offer, using innovative technology to sell products into specialized markets. The strength of our competitive positions in many of our existing markets is largely due to our leading technology, which is the result of continuing significant investments in product research and development. However, we may enter new markets, whether through acquisitions or new internal product development, in which

competition is based primarily on product pricing, not technological superiority. Further, some new growth markets that emerge may not require leading technologies. Loss of competitive position in any of the markets we serve, or an inability to sell our products on favorable commercial terms in new markets we may enter, could negatively affect our prices, customer orders, revenues, gross margins and market share, any of which would negatively affect our operating results and financial condition.

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Our business would be harmed if we do not receive parts sufficient in number and performance to meet our production requirements and product specifications in a timely and cost-effective manner.

We use a wide range of materials in the production of our products, including custom electronic and mechanical components, and we use numerous suppliers to supply these materials. We generally do not have guaranteed supply arrangements with our suppliers. Because of the variability and uniqueness of customers' orders, we do not maintain an extensive inventory of materials for manufacturing. Through our business interruption planning, we seek to minimize the risk of production and service interruptions and/or shortages of key parts by, among other things, monitoring the financial stability of key suppliers, identifying (but not necessarily qualifying) possible alternative suppliers and maintaining appropriate inventories of key parts. Although we make reasonable efforts to ensure that parts are available from multiple suppliers, key parts may be available only from a single supplier or a limited group of suppliers. Also, key parts we obtain from some of our suppliers incorporate the suppliers' proprietary intellectual property; in those cases we are increasingly reliant on third parties for high-performance, high-technology components, which reduces the amount of control we have over the availability and protection of the technology and intellectual property that is used in our products. In addition, if certain of our key suppliers experience liquidity issues and are forced to discontinue operations, which is a heightened risk during economic downturns, that would affect their ability to deliver parts and could result in delays for our products. Our operating results and business may be adversely impacted if we are unable to obtain parts to meet our production requirements and product specifications, or if we are only able to do so on unfavorable terms.

If we fail to operate our business in accordance with our business plan, our operating results, business and stock price may be significantly and adversely impacted.

We attempt to operate our business in accordance with a business plan that is established annually, revised frequently (generally quarterly), and reviewed by management even more frequently (at least monthly). Our business plan is developed based on a number of factors, many of which require estimates and assumptions, such as our expectations of the economic environment, future business levels, our customers' willingness and ability to place orders, lead-times, and future revenue and cash flow. Our budgeted operating expenses, for example, are based in part on our future revenue expectations. However, our ability to achieve our anticipated revenue levels is a function of numerous factors, including the volatile and cyclical nature of our industry, customer order cancellations, macroeconomic changes, operational matters regarding particular agreements, our ability to manage customer deliveries and resources for the installation and acceptance of our products (for products where customer acceptance is required before we can recognize revenue from such sales), our ability to manage delays or accelerations by customers in taking deliveries and the acceptance of our products (for products where customer acceptance is required before we can recognize revenue from such sales), our ability to operate our business and sales processes effectively, and a number of the other risk factors set forth in this Item 1A.

Because our expenses are in most cases relatively fixed in the short term, any revenue shortfall below expectations could have an immediate and significant adverse effect on our operating results. Similarly, if we fail to manage our expenses effectively or otherwise fail to maintain rigorous cost controls, we could experience greater than anticipated expenses during an operating period, which would also negatively affect our results of operations. If we fail to operate our business consistent with our business plan, our operating results in any period may be significantly and adversely impacted. Such an outcome could cause customers, suppliers or investors to view us as less stable, or could cause us to fail to meet financial analysts' revenue or earnings estimates, any of which could have a material adverse impact on our business, financial condition or stock price.

In addition, our management is constantly striving to balance the requirements and demands of our customers with the availability of resources, the need to manage our operating model and other factors. In furtherance of those efforts, we often must exercise discretion and judgment as to the timing and prioritization of manufacturing, deliveries, installations and payment scheduling. Any such decisions may impact our ability to recognize revenue, including the fiscal period during which such revenue may be recognized, with respect to such products, which could have a material adverse effect on our business, financial condition or stock price.

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There can be no assurance that we will continue to declare cash dividends at all or in any particular amounts.

Our Board of Directors first instituted a quarterly dividend during the fiscal year ended June 30, 2005. Since that time, we have announced several increases in the amount of our quarterly dividend level. We intend to continue to pay quarterly dividends subject to capital availability and periodic determinations by our Board of Directors that cash dividends are in the best interest of our stockholders and are in compliance with all laws and agreements applicable to the declaration and payment of cash dividends by us. Future dividends may be affected by, among other factors: our views on potential future capital requirements for investments in acquisitions and the funding of our research and development; legal risks; stock repurchase programs; changes in federal and state income tax laws or corporate laws; and changes to our business model. Our dividend payments may change from time to time, and we cannot provide assurance that we will continue to declare dividends at all or in any particular amounts. A reduction in our dividend payments could have a negative effect on our stock price.

There are risks associated with our outstanding indebtedness.

As of September 30, 2011, we had $750 million aggregate principal amount of outstanding indebtedness represented by our senior notes that will mature in 2018, and we may incur additional indebtedness in the future. Our ability to pay interest and repay the principal for our indebtedness is dependent upon our ability to manage our business operations and the other risk factors discussed in this section. There can be no assurance that we will be able to manage any of these risks successfully.

In addition, changes by any rating agency to our outlook or credit rating could negatively affect the value and liquidity of both our debt and equity securities. Factors that can affect our credit rating include changes in our operating performance, the economic environment, conditions in the semiconductor and semiconductor equipment industries, our financial position, and changes in our business strategy.

In certain circumstances involving a change of control followed by a downgrade of the rating of our senior notes, we 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. We cannot make any assurance that we will have sufficient financial resources at such time or will be able to arrange financing to pay the repurchase price of the senior notes. Our 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 we may be party at such time. If we fail 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 our obligations.

We are exposed to risks related to our commercial terms and conditions, including our indemnification of third parties, as well as the performance of our products.

Although our standard commercial documentation sets forth the terms and conditions that we intend to apply to commercial transactions with our business partners, counterparties to such transactions may not explicitly agree to our terms and conditions. In situations where we engage in business with a third party without an explicit master agreement regarding the applicable terms and conditions, or where the commercial documentation applicable to the transaction is subject to varying interpretations, we may have disputes with those third parties regarding the applicable terms and conditions of our business relationship with them. Such disputes could lead to a deterioration of our commercial relationship with those parties, costly and time-consuming litigation, or additional concessions or obligations being offered by us to resolve such disputes, or could impact our revenue or cost recognition. Any of these outcomes could materially and adversely affect our business, financial condition and results of operations.

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In addition, in our commercial agreements, from time to time in the normal course of business we indemnify third parties with whom we enter into contractual relationships, including customers and lessors, with respect to certain matters. We have agreed, under certain conditions, to hold these third parties harmless against specified losses, such as those arising from a breach of representations or covenants, other third party claims that our products when used for their intended purposes infringe the intellectual property rights of such other third parties, or other claims made against certain parties. We may be compelled to enter into or accrue for probable settlements of alleged indemnification obligations, or we may be subject to potential liability arising from our customers' involvements in legal disputes. In addition, notwithstanding the provisions related to limitations on our liability that we seek to include in our business agreements, the counterparties to such agreements may dispute our interpretation or application of such provisions, and a court of law may not interpret or apply such provisions in our favor, any of which could result in an obligation for us to pay material damages to third parties and engage in costly legal proceedings. It is difficult to determine the maximum potential amount of liability under any indemnification obligations, whether or not asserted, due to our limited history of prior indemnification claims and the unique facts and circumstances that are likely to be involved in any particular claim. Our business, financial condition and results of operations in a reported fiscal period could be materially and adversely affected if we expend significant amounts in defending or settling any purported claims, regardless of their merit or outcomes.

We are also exposed to potential costs associated with unexpected product performance issues. Our products and production processes are extremely complex and thus could contain unexpected product defects, especially when products are first introduced. Unexpected product performance issues could result in significant costs being incurred by us, including increased service or warranty costs, providing product replacements for (or modifications to) defective products, litigation related to defective products, product recalls, or product write-offs or disposal costs. These costs could be substantial and could have an adverse impact upon our business, financial condition and operating results. In addition, our reputation with our customers could be damaged as a result of such product defects, which could reduce demand for our products and negatively impact our business.

There are risks associated with our receipt of government funding for research and development.

We are exposed to additional risks related to our receipt of external funding for certain strategic development programs from various governments and government agencies, both domestically and internationally. Governments and government agencies typically have the right to terminate funding programs at any time in their sole discretion, so there is no assurance that these sources of external funding will continue to be available to us in the future. In addition, under the terms of these government grants, the applicable granting agency typically has the right to audit the costs that we incur, directly and indirectly, in connection with such programs. Any such audit could result in modifications to, or even termination of, the applicable government funding program. For example, if an audit were to identify any costs as being improperly allocated to the applicable program, those costs would not be reimbursed, and any such costs that had already been reimbursed would have to be refunded. We do not know the outcome of any future audits. Any adverse finding resulting from any such audit could lead to penalties (financial or otherwise), termination of funding programs, suspension of payments, fines and suspension or prohibition from receiving future government funding from the applicable government or government agency, any of which could adversely impact our operating results, financial condition and ability to operate our business.

We have recorded significant restructuring, inventory write-off and asset impairment charges in the past and may do so again in the future, which could have a material negative impact on our business.

During the fiscal year ended June 30, 2009, we recorded material restructuring charges of $38.7 million related to our global workforce reduction, large excess inventory write-offs of $85.6 million, and material impairment charges of $446.7 million related to our goodwill and purchased intangible assets. If we were to encounter challenging economic conditions once again, we may implement additional cost reduction actions, which would require us to take additional, potentially material, restructuring charges related to, among other things, employee terminations or exit costs. We may also be required to write off additional inventory if our product build plans or usage of service inventory decline, and such additional write-offs could constitute material charges.

As noted above, we recorded a material charge during the fiscal year ended June 30, 2009 related to the impairment of our goodwill and purchased intangible assets. Goodwill represents the excess of costs over the net fair value of net assets acquired in a business combination. Goodwill is not amortized, but is instead tested for impairment at least annually in accordance with authoritative guidance for goodwill. Purchased intangible assets with estimable useful lives are amortized over their respective estimated useful lives using the straight-line method, and are reviewed for impairment in accordance with authoritative guidance for long-lived assets. The valuation of goodwill and intangible assets requires assumptions and estimates of many critical factors, including revenue and market growth, operating cash flows, market multiples, and discount rates. A substantial decline in our stock price, or any other adverse change in market conditions, particularly if such change has the effect of changing one of the critical assumptions or estimates we previously used to calculate the value of our goodwill or intangible assets (and, as applicable, the amount of any previous impairment charge), could result in a change to the estimation of fair value that could result in an additional impairment charge.

Any such additional material charges, whether related to restructuring or goodwill or purchased intangible asset impairment, may have a material negative impact on our operating results and related financial statements.

We are exposed to risks related to our financial arrangements with respect to receivables factoring and banking arrangements.

We enter into factoring arrangements with financial institutions to sell certain of our trade receivables and promissory notes from customers without recourse. In addition, we maintain bank accounts with several domestic and foreign financial institutions, any of which may prove not to be financially viable. If we were to stop entering into these factoring arrangements, our operating results, financial condition and cash flows could be adversely impacted by delays or failures in collecting trade receivables. However, by entering into these arrangements, and by engaging these financial institutions for banking services, we are exposed to additional risks. If any of these financial institutions experiences financial difficulties or is otherwise unable to honor the terms of our factoring or deposit arrangements, we may experience material financial losses due to the failure of such arrangements or a lack of access to our funds, any of which could have an adverse impact upon our operating results, financial condition and cash flows.

We are subject to the risks of additional government actions in the event we were to breach the terms of any settlement arrangement into which we have entered.

In connection with the settlement of certain government actions and other legal proceedings related to our historical stock option practices, we have explicitly agreed as a condition to such settlements that we will comply with certain laws, such as the books and records provisions of the federal securities laws. If we were to violate any such law, we might not only be subject to the significant penalties applicable to such violation, but our past settlements may also be impacted by such violation, which could give rise to additional government actions or other legal proceedings. Any such additional actions or proceedings may require us to expend significant management time and incur significant accounting, legal and other expenses, and may divert attention and resources from the operation of our business. These expenditures and diversions, as well as an adverse resolution of any such action or proceeding, could have a material adverse effect on our business, financial condition and results of operations.

General Commercial, Operational, Financial and Regulatory Risks

We are exposed to risks associated with a weakening in the condition of the financial markets and the global economy.

The severe tightening of the credit markets, turmoil in the financial markets and weakening of the global economy that were experienced during the fiscal year ended June 30, 2009 contributed to slowdowns in the industries in which we operate, which slowdowns could recur or worsen if economic conditions were to deteriorate again.

The markets for semiconductors, and therefore our business, are ultimately driven by the global demand for electronic devices by consumers and businesses. Economic uncertainty frequently leads to reduced consumer and business spending, which caused our customers to decrease, cancel or delay their equipment and service orders from us in the economic slowdown during fiscal year 2009. In addition, the tightening of credit markets and concerns regarding the availability of credit that accompanied that slowdown made it more difficult for our customers to raise capital, whether debt or equity, to finance their purchases of capital equipment, including the products we sell. Reduced demand, combined with delays in our customers' ability to obtain financing (or the unavailability of such financing),

has at times in the past several years adversely affected our product and service sales and revenues and therefore has harmed our business and operating results, and our operating results and financial condition may again be adversely impacted if economic conditions decline from their current levels.

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In addition, a decline in the condition of the global financial markets could adversely impact the market values or liquidity of our investments. Our investment portfolio includes corporate and government securities, money market funds and other types of debt and equity investments. Although we believe our portfolio continues to be comprised of sound investments due to the quality and (where applicable) credit ratings and government guarantees of the underlying investments, a decline in the capital and financial markets would adversely impact the market value of our investments and their liquidity. If the market value of such investments were to decline, or if we were to have to sell some of our investments under illiquid market conditions, we may be required to recognize an impairment charge on such investments or a loss on such sales, either of which could have an adverse effect on our financial condition and operating results.

If we are unable to timely and appropriately adapt to changes resulting from difficult macroeconomic conditions, our business, financial condition or results of operations may be materially and adversely affected.

A majority of our annual revenues are derived from outside the United States, and we maintain significant operations outside the United States. We are exposed to numerous risks as a result of the international nature of our business and operations.

A majority of our annual revenues are derived from outside the United States, and we maintain significant operations outside the United States. We expect that these conditions will continue in the foreseeable future. Managing global operations and sites located throughout the world presents a number of challenges, including but not limited to:

- managing cultural diversity and organizational alignment;
- exposure to the unique characteristics of each region in the global semiconductor market, which can cause capital equipment investment patterns to vary significantly from period to period;
- periodic local or international economic downturns;
- potential adverse tax consequences, including withholding tax rules that may limit the repatriation of our earnings, and higher effective income tax rates in foreign countries where we do business;
- government controls, either by the United States or other countries, that restrict our business overseas or the import or export of semiconductor products or increase the cost of our operations;
- tariffs or other trade barriers (including those applied to our products or to parts and supplies that we purchase);
- political instability, natural disasters, legal or regulatory changes, acts of war or terrorism in regions where we have operations or where we do business;
- fluctuations in interest and currency exchange rates (Although we attempt to manage near-term currency risks through the use of hedging instruments, there can be no assurance that such efforts will be adequate);
- longer payment cycles and difficulties in collecting accounts receivable outside of the United States;
- difficulties in managing foreign distributors (including monitoring and ensuring our distributors' compliance with all applicable United States and local laws); and
- inadequate protection or enforcement of our intellectual property and other legal rights in foreign jurisdictions.

Any of the factors above could have a significant negative impact on our business and results of operations.

We might be involved in intellectual property disputes or other intellectual property infringement claims that may be costly to resolve, prevent us from selling or using the challenged technology and seriously harm our operating results and financial condition.

As is typical in the semiconductor equipment industry, from time to time we have received communications from other parties asserting the existence of patent rights, copyrights, trademark rights or other intellectual property rights which they believe cover certain of our products, processes, technologies or information. In addition, we occasionally receive notification from customers who believe that we owe them indemnification or other obligations related to intellectual property claims made against such customers by third parties. Litigation tends to be expensive and requires significant management time and attention and could have a negative effect on our results of operations or business if we lose or have to settle a case on significantly adverse terms. Our customary practice is to evaluate such infringement assertions and to consider whether to seek licenses where appropriate. However, we cannot ensure that licenses can be obtained or, if obtained, will be on acceptable terms or that costly litigation or other administrative proceedings will not occur. The inability to obtain necessary licenses or other rights on reasonable terms, or the instigation of litigation or other administrative proceedings, could seriously harm our operating results and financial

condition.

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We are exposed to various risks related to the legal (including environmental), regulatory and tax environments in which we perform our operations and conduct our business.

We are subject to various risks related to compliance with new, existing, different, inconsistent or even conflicting laws, rules and regulations enacted by legislative bodies and/or regulatory agencies in the countries in which we operate and with which we must comply, including environmental, safety, antitrust, anti-corruption/anti-bribery and export control regulations. Our failure or inability to comply with existing or future laws, rules or regulations, or changes to existing laws, rules or regulations (including changes that result in inconsistent or conflicting laws, rules or regulations), in the countries in which we operate could result in violations of contractual or regulatory obligations that may adversely affect our operating results, financial condition and ability to conduct our business.

Our properties and many aspects of our business operations are subject to various domestic and international environmental laws and regulations, including those that control and restrict the use, transportation, emission, discharge, storage and disposal of certain chemicals, gases and other substances. Any failure to comply with applicable environmental laws, regulations or requirements may subject us to a range of consequences, including fines, suspension of certain of our business activities, limitations on our ability to sell our products, obligations to remediate environmental contamination, and criminal and civil liabilities or other sanctions. In addition, changes in environmental regulations (including regulations relating to climate change and greenhouse gas emissions) could require us to invest in potentially costly pollution control equipment, alter our manufacturing processes or use substitute (potentially more expensive and/or rarer) materials. Further, we use hazardous and other regulated materials that subject us to risks of strict liability for damages caused by any release, regardless of fault. We also face increasing complexity in our manufacturing, product design and procurement operations as we adjust to new and prospective requirements relating to the materials composition of our products, including restrictions on lead and other substances and requirements to track the sources of certain metals and other materials. The cost of complying, or of failing to comply, with these and other regulatory restrictions or contractual obligations could adversely affect our operating results, financial condition and ability to conduct our business.

In addition, we may from time to time be involved in legal proceedings or claims regarding employment, contracts, product performance, product liability, antitrust, environmental regulations, securities, unfair competition and other matters (in addition to proceedings and claims related to intellectual property matters, which are separately discussed elsewhere in this Item 1A). These legal proceedings and claims, regardless of their merit, may be time-consuming and expensive to prosecute or defend, divert management’s attention and resources, and/or inhibit our ability to sell our products. There can be no assurance regarding the outcome of current or future legal proceedings or claims, which could adversely affect our operating results, financial condition and ability to operate our business.

We depend on key personnel to manage our business effectively, and if we are unable to attract, retain and motivate our key employees, our sales and product development could be harmed.

Our employees are vital to our success, and our key management, engineering and other employees are difficult to replace. We generally do not have employment contracts with our key employees. Further, we do not maintain key person life insurance on any of our employees. The expansion of high technology companies worldwide has increased demand and competition for qualified personnel. If we are unable to retain key personnel, or if we are not able to attract, assimilate and retain additional highly qualified employees to meet our needs in the future, our business and operations could be harmed.

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We outsource a number of services to third-party service providers, which decreases our control over the performance of these functions. Disruptions or delays at our third-party service providers could adversely impact our operations.
We outsource a number of services, including our transportation and logistics management of spare parts and certain accounting functions, to domestic and overseas third-party service providers. While outsourcing arrangements may lower our cost of operations, they also reduce our direct control over the services rendered. It is uncertain what effect such diminished control will have on the quality or quantity of products delivered or services rendered, on our ability to quickly respond to changing market conditions, or on our ability to ensure compliance with all applicable domestic and foreign laws and regulations. In addition, many of these outsourced service providers, including certain hosted software applications that we use for confidential data storage, employ “cloud computing” technology for such storage (which refers to an information technology hosting and delivery system in which data is not stored within the user's physical infrastructure but instead are delivered to and consumed by the user as an Internet-based service). These providers' cloud computing systems may be susceptible to “cyber incidents,” such as intentional cyber attacks aimed at theft of sensitive data or inadvertent cyber-security compromises, that are outside of our control. If we do not effectively develop and manage our outsourcing strategies, if required export and other governmental approvals are not timely obtained, if our third-party service providers do not perform as anticipated, or do not adequately protect our data from cyber-related security breaches, or if there are delays or difficulties in enhancing business processes, we may experience operational difficulties (such as limitations on our ability to ship products), increased costs, manufacturing or service interruptions or delays, loss of intellectual property rights or other sensitive data, quality and compliance issues, and challenges in managing our product inventory or recording and reporting financial and management information, any of which could materially and adversely affect our business, financial condition and results of operations.
We rely upon certain critical information systems for our daily business operation. Our inability to use or access these information systems at critical points in time could unfavorably impact the timeliness and efficiency of our business operations.
Our global operations are linked by information systems, including telecommunications, the internet, our corporate intranet, network communications, email and various computer hardware and software applications. Despite our implementation of network security measures, our tools and servers are vulnerable to computer viruses, break-ins and similar disruptions from unauthorized tampering with our computer systems and tools located at customer sites, or could be subject to system failures or malfunctions for other reasons. System failures or malfunctioning, such as difficulties with our customer relationship management (“CRM”) system, could disrupt our operations and our ability to timely and accurately process and report key components of our financial results. Our enterprise resource planning (“ERP”) system is integral to our ability to accurately and efficiently maintain our books and records, record transactions, provide critical information to our management, and prepare our financial statements. Any disruptions or difficulties that may occur in connection with our ERP system or other systems (whether in connection with the regular operation, periodic enhancements, modifications or upgrades of such systems or the integration of our acquired businesses into such systems) could adversely affect our ability to complete important business processes, such as the evaluation of our internal control over financial reporting pursuant to Section 404 of the Sarbanes-Oxley Act of 2002. Any such event could have an adverse effect on our business, operating results and financial condition.
Acquisitions are an important element of our strategy but, because of the uncertainties involved, we may not find suitable acquisition candidates and we may not be able to successfully integrate and manage acquired businesses. We are also exposed to risks in connection with strategic alliances into which we may enter.
In addition to our efforts to develop new technologies from internal sources, part of our growth strategy is to pursue acquisitions and acquire new technologies from external sources. As part of this effort, we may make acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies. There can be no assurance that we will find suitable acquisition candidates or that acquisitions we complete will be successful. In addition, we may use equity to finance future acquisitions, which would increase our number of shares outstanding and be dilutive to current stockholders.

If we are unable to successfully integrate and manage acquired businesses or if acquired businesses perform poorly, then our business and financial results may suffer. It is possible that the businesses we have acquired, as well as businesses that we may acquire in the future, may perform worse than expected or prove to be more difficult to integrate and manage than expected. In addition, we may lose key employees of the acquired companies. As a result, risks associated with acquisition transactions may give rise to a material adverse effect on our business and financial results for a number of reasons, including:

- we may have to devote unanticipated financial and management resources to acquired businesses;
- the combination of businesses may cause the loss of key personnel or an interruption of, or loss of momentum in, the activities of our company and/or the acquired business;
- we may not be able to realize expected operating efficiencies or product integration benefits from our acquisitions;
- we may experience challenges in entering into new market segments for which we have not previously manufactured and sold products;
- we may face difficulties in coordinating geographically separated organizations, systems and facilities;
- the customers, distributors, suppliers, employees and others with whom the companies we acquire have business dealings may have a potentially adverse reaction to the acquisition;
- we may have to write-off goodwill or other intangible assets; and
- we may incur unforeseen obligations or liabilities in connection with acquisitions.

At times, we may also enter into strategic alliances with customers, suppliers or other business partners with respect to development of technology and intellectual property. These alliances typically require significant investments of capital and exchange of proprietary, highly sensitive information. The success of these alliances depends on various factors over which we may have limited or no control and requires ongoing and effective cooperation with our strategic partners. Mergers and acquisitions and strategic alliances are inherently subject to significant risks, and the inability to effectively manage these risks could materially and adversely affect our business, financial condition and operating results.

Disruption of our manufacturing facilities or other operations, or in the operations of our customers, due to earthquake, flood, other natural catastrophic events, health epidemics or terrorism could result in cancellation of orders, delays in deliveries or other business activities, or loss of customers and could seriously harm our business.
We have significant manufacturing operations in the United States, Singapore, Israel, Belgium and Germany. In addition, our business is international in nature, with our sales, service and administrative personnel and our customers located in numerous countries throughout the world. Operations at our manufacturing facilities and our assembly subcontractors, as well as our other operations and those of our customers, are subject to disruption for a variety of reasons, including work stoppages, acts of war, terrorism, health epidemics, fire, earthquake, volcanic eruptions, energy shortages, flooding or other natural disasters. Such disruption could cause delays in, among other things, shipments of products to our customers, our ability to perform services requested by our customers, or the installation and acceptance of our products at customer sites. We cannot ensure that alternate means of conducting our operations (whether through alternate production capacity or service providers or otherwise) would be available if a major disruption were to occur or that, if such alternate means were available, they could be obtained on favorable terms.
For example, recent events in Japan, including earthquakes, tsunamis and the related damage, have affected the operations of some of our customers and suppliers in that region, and may also have impacted the operations of some of our customers' other suppliers (which could impact our customers' desire to proceed with broad-based facility upgrades and related equipment purchases) or some of our suppliers' suppliers (which could impact our suppliers' ability to deliver their products to us in a timely manner). In the coming quarters, the recent events in Japan could result in delays in orders and deliveries and the other effects described earlier in this paragraph, any of which could materially and adversely affect our business, financial condition and operating results.

In addition, as part of our cost-cutting actions, we have consolidated several operating facilities. Our California operations are now primarily centralized in our Milpitas facility. The consolidation of our California operations into a single campus could further concentrate the risks related to any of the disruptive events described above, such as acts of war or terrorism, earthquakes, fires or other natural disasters, if any such event were to impact our Milpitas facility.

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We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war. If international political instability continues or increases, our business and results of operations could be harmed.
The threat of terrorism targeted at, or acts of war in, the regions of the world in which we do business increases the uncertainty in our markets. Any act of terrorism or war that affects the economy or the semiconductor industry could adversely affect our business. Increased international political instability in various parts of the world, disruption in air transportation and further enhanced security measures as a result of terrorist attacks may hinder our ability to do business and may increase our costs of operations. We maintain significant manufacturing and research and development operations in Israel, an area that has historically experienced a high degree of political instability, and we are therefore exposed to risks associated with future instability in that region. Such instability could directly impact our ability to operate our business (or our customers' ability to operate their business) in the affected region, cause us to incur increased costs in transportation, make such transportation unreliable, increase our insurance costs, and cause international currency markets to fluctuate. This same instability could have the same effects on our suppliers and their ability to timely deliver their products. If international political instability continues or increases in any region in which we do business, our business and results of operations could be harmed. We are predominantly uninsured for losses and interruptions caused by terrorist acts and acts of war.
We self insure certain risks including earthquake risk. If one or more of the uninsured events occurs, we could suffer major financial loss.
We purchase insurance to help mitigate the economic impact of certain insurable risks; however, certain other risks are uninsurable or are insurable only at significant cost or cannot be mitigated with insurance. An earthquake could significantly disrupt our manufacturing operations, a significant portion of which are conducted in California, an area highly susceptible to earthquakes. It could also significantly delay our research and engineering efforts on new products, much of which is also conducted in California. We take steps to minimize the damage that would be caused by an earthquake, but there is no certainty that our efforts will prove successful in the event of an earthquake. We self insure earthquake risks because we believe this is a prudent financial decision based on our large cash reserves and the high cost and limited coverage available in the earthquake insurance market. Certain other risks are also self-insured either based on a similar cost-benefit analysis, or based on the unavailability of insurance. If one or more of the uninsured events occurs, we could suffer major financial loss.
We are exposed to foreign currency exchange rate fluctuations. Although we hedge certain currency risks, we may still be adversely affected by changes in foreign currency exchange rates or declining economic conditions in these countries.
We have exposure to fluctuations in foreign currency exchange rates, primarily the Euro and the Japanese Yen. We have international subsidiaries that operate and sell our products globally. In addition, an increasing proportion of our manufacturing activities are conducted outside of the United States, and many of the costs associated with such activities are denominated in foreign currencies. We routinely hedge our exposures to certain foreign currencies with certain financial institutions in an effort to minimize the impact of certain currency exchange rate fluctuations, but these hedges may be inadequate to protect us from currency exchange rate fluctuations. To the extent that these hedges are inadequate, or if there are significant currency exchange rate fluctuations in currencies for which we do not have hedges in place, our reported financial results or the way we conduct our business could be adversely affected. Furthermore, if a financial counterparty to our hedges experiences financial difficulties or is otherwise unable to honor the terms of the foreign currency hedge, we may experience material financial losses.
We are exposed to fluctuations in interest rates and the market values of our portfolio investments; impairment of our investments could harm our earnings. In addition, we and our stockholders are exposed to risks related to the volatility of the market for our common stock.
Our investment portfolio primarily consists of both corporate and government debt securities that have a maximum effective 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 market interest rates and bond yields increase, those securities with a lower yield-at-cost show a mark-to-market unrealized loss. We have the ability to realize the full value of all these investments upon maturity. However, an impairment of the fair market value of our investments, even if unrealized, must be reflected in our financial statements for the applicable period and may therefore have a material adverse effect

on our results of operations for that period.



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In addition, the market price for our common stock is volatile and has fluctuated significantly during recent years. The trading price of our common stock could continue to be highly volatile and fluctuate widely in response to various factors, including without limitation conditions in the semiconductor industry and other industries in which we operate, fluctuations in the global economy or capital markets, our operating results or other performance metrics, or adverse consequences experienced by us as a result of any of the risks described elsewhere in this Item 1A. Volatility in the market price of our common stock could cause an investor in our common stock to experience a loss on the value of their investment in us and could also adversely impact our ability to raise capital through the sale of our common stock or to use our common stock as consideration to acquire other companies.

We are exposed to risks in connection with tax audits in various jurisdictions.

We are subject to tax audits in various jurisdictions, and such jurisdictions may assess additional income or other taxes against us. Although we believe our tax estimates are reasonable, the final determination of tax audits and any related litigation could be materially different from our historical income tax provisions and accruals. The results of an audit or litigation could have a material adverse effect on our operating results or cash flows in the period or periods for which that determination is made.

A change in our effective tax rate can have a significant adverse impact on our business.

A number of factors may adversely impact our future effective tax rates, such as the jurisdictions in which our profits are determined to be earned and taxed; the resolution of issues arising from tax audits with various tax authorities; changes in the valuation of our deferred tax assets and liabilities; adjustments to estimated taxes upon finalization of various tax returns; increases in expenses not deductible for tax purposes, including write-offs of acquired in-process research and development and impairment of goodwill in connection with acquisitions; changes in available tax credits; changes in stock-based compensation expense; changes in tax laws or the interpretation of such tax laws (for example, proposals for fundamental United States international tax reform; changes in generally accepted accounting principles; and the repatriation of earnings from outside the United States for which we have not previously provided for United States taxes. A change in our effective tax rate can adversely impact our results from operations.

Compliance with federal securities laws, rules and regulations, as well as NASDAQ requirements, is becoming increasingly complex, and the significant attention and expense we must devote to those areas may have an adverse impact on our business.

Federal securities laws, rules and regulations, as well as NASDAQ rules and regulations, require companies to maintain extensive corporate governance measures, impose comprehensive reporting and disclosure requirements, set strict independence and financial expertise standards for audit and other committee members and impose civil and criminal penalties for companies and their chief executive officers, chief financial officers and directors for securities law violations. These laws, rules and regulations have increased, and in the future are expected to continue to increase, the scope, complexity and cost of our corporate governance, reporting and disclosure practices, which could harm our results of operations and divert management’s attention from business operations.

A change in accounting standards or practices or a change in existing taxation rules or practices (or changes in interpretations of such standards, practices or rules) can have a significant effect on our reported results and may even affect reporting of transactions completed before the change is effective.

New accounting pronouncements and taxation rules and varying interpretations of accounting pronouncements and taxation rules have occurred and will continue to occur in the future. Changes to (or revised interpretations or applications of) existing tax or accounting rules or the questioning of current or past practices may adversely affect our reported financial results or the way we conduct our business.

For example, the adoption of the authoritative guidance for stock-based compensation, which required us to measure all employee stock-based compensation awards using a fair value method beginning in fiscal year 2006 and record such expense in our consolidated financial statements, has had a material impact on our consolidated financial statements, as reported under accounting principles generally accepted in the United States.

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ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Equity Repurchase Plans

The following is a summary of stock repurchases for the three months ended September 30, 2011 (1):

| Period | Total Number of Shares Purchased (2) | Average Price Paid per Share | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (3) |
|---|---|---|---|
| July1, 2011 to July 31, 2011 | 431,653 | $ 41.85 | 8,584,661 |
| August 1, 2011 to August 31, 2011 | 707,199 | $ 36.06 | 7,877,462 |
| September 1, 2011 to September 30, 2011 | 624,505 | $ 37.50 | 7,252,957 |
| Total | 1,763,357 | $ 37.99 | |

(1) In July 1997, our Board of Directors authorized us to systematically repurchase up to 17.8 million shares of our common stock in the open market. This plan was put into place to reduce the dilution from our employee benefit and incentive plans, such as our equity incentive and employee stock purchase plans, and to return excess cash to our stockholders. Our Board of Directors has authorized us to repurchase additional shares of our common stock under the repurchase program in February 2005 (up to 10.0 million shares), February 2007 (up to 10.0 million shares), August 2007 (up to 10.0 million shares), June 2008 (up to 15.0 million shares), and February 2011 (up to 10.0 million shares), in each case in addition to the originally authorized 17.8 million shares described in the first sentence of this footnote.

(2) All shares were purchased pursuant to the publicly announced repurchase program described in footnote 1 above.

(3) The stock repurchase program has no expiration date. Future repurchases of our common stock under our repurchase program may be effected through various different repurchase transaction structures, including isolated open market transactions or systematic repurchase plans.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. (REMOVED AND RESERVED)

ITEM 5. OTHER INFORMATION

None.

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ITEM 6. EXHIBITS

| | |
|---|---|
| 10.43 | Fiscal Year 2012 Executive Incentive Plan * + |
| 31.1 | Certification of Chief Executive Officer Under Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934. |
| 31.2 | Certification of Chief Financial Officer Under Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934. |
| 32 | Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C Section 1350. |
| 101.INS | XBRL Instance Document |
| 101.SCH | XBRL Taxonomy Extension Schema Document |
| 101.CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB | XBRL Taxonomy Extension Label Document |
| 101.PRE | XBRL Taxonomy Definition Presentation Document |

* Denotes a management contract, plan or arrangement.
\+ Confidential treatment has been requested as to a portion of this exhibit.

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SIGNATURES

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

| | |
|---|---|
| | KLA-Tencor Corporation<br>(Registrant) |
| October 27, 2011<br>(Date) | /s/ RICHARD P. WALLACE<br>Richard P. Wallace<br>President and Chief Executive Officer<br>(Principal Executive Officer) |
| October 27, 2011<br>(Date) | /s/ MARK P. DENTINGER<br>Mark P. Dentinger<br>Executive Vice President and Chief Financial Officer<br>(Principal Financial Officer) |
| October 27, 2011<br>(Date) | /s/ VIRENDRA A. KIRLOSKAR<br>Virendra A. Kirloskar<br>Senior Vice President and Chief Accounting Officer<br>(Principal Accounting Officer) |

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KLA-TENCOR CORPORATION
EXHIBIT INDEX

| Exhibit Number | Exhibit Description | Incorporated by Reference | | | |
|---|---|---|---|---|---|
| | | Form | File Number | Exhibit Number | Filing Date |
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