



KLA-Tencor Corporation (KLAC)

Updated June 8th, 2018 by Jonathan Weber

Key Metrics

Current Price: \$116	5 Year CAGR Estimate: 12.8%	Quality Percentile: N/A
Fair Value Price: \$125	5 Year Growth Estimate: 8.6%	Momentum Percentile: N/A
% Fair Value: 93%	5 Year Valuation Multiple Estimate: 1.6%	Total Return Percentile: N/A
Dividend Yield: 2.6%	5 Year Price Target: \$190	Valuation Percentile:

Overview & Current Events

KLA-Tencor Corporation is a supplier to the semiconductor industry. The company supplies process control and yield management systems for semiconductor producers such as TSMC, Samsung and Micron. KLA-Tencor was founded in 1997 (through a merger between KLA Instruments and Tencor Instruments). It is headquartered in Milpitas, CA, and is currently valued at \$18 billion.

KLA-Tencor's most recent quarterly results were announced on April 26, the company earned \$2.02 per share, a strong 25% increase over the prior year's \$1.62 in EPS. KLA-Tencor was also able to grow its revenues by 12% year over year, to \$1.02 billion.

Growth on a Per-Share Basis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
EPS	\$2.78	-	\$1.54	\$4.91	\$4.64	\$3.21	\$3.47	\$2.98	\$4.66	\$5.94	\$7.85	\$11.85
DPS	\$0.60	\$0.60	\$0.60	\$1.00	\$1.40	\$1.60	\$1.80	\$2.00	\$2.08	\$2.14	\$2.84	\$4.85

KLA-Tencor has grown its earnings per share by 9% annually between 2008 and 2017, although growth has been quite uneven: During 2009 the company reported net losses, and the company reported year-over-year earnings declines several times since then. Growth has seemingly stabilized during the last couple of years, from 2015 to 2017 the company reported strong results, and 2018 will be an even better year for the company.

KLA-Tencor's EPS growth has historically come from a mix of revenue growth, margin improvements, and share repurchases. The revenue growth outlook remains strong, with the company's most recent quarter showing revenue growth of 12%. Right now the majority of KLA-Tencor's revenues come from product sales, but service revenues are growing at an even faster pace (16% yoy in the most recent quarter) and make up about 20% of total sales already. This is a positive in the long run, as a higher rate of service revenues will help KLA-Tencor's top line become less cyclical. The semiconductor industry profits from massive tailwinds such as the Internet of Things, big data, autonomous driving, cloud computing, etc. These trends in turn drive demand for chips which means that companies such as Samsung and TSMC are increasing capacity to be able to meet demand. New plants and machinery acquisition by semiconductor manufacturers means, in turn, that demand for KLA-Tencor's products will likely remain strong. KLA-Tencor has also made several acquisitions in the past, which have added to its growth. Tthe \$3.4 billion takeover of Orbotech (ORBK) that was announced in March 2018 was the latest.

In 2018 KLA-Tencor is also benefitting from a lower tax rate, which is why EPS will grow at a very compelling rate this year. KLA-Tencor has reduced its share count meaningfully in the last couple of years, which has added to EPS growth as well, but since 2016 the share count has stopped declining, although KLA-Tencor plans to increase its buyback activity going forward. Overall the company has solid growth prospects ahead.

Valuation Analysis

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	Now	2023
Avg. P/E	17.3	---	20.9	7.9	9.9	15.9	18.2	22.8	13.6	14.1	14.8	16.0
Avg. Yld.	1.2%	2.4%	1.9%	2.6%	3.0%	3.1%	2.8%	2.9%	3.3%	2.5%	2.6%	2.5%

KLA-Tencor trades at a relatively inexpensive valuation of a little less than 15 times this year’s earnings, versus a long-term median P/E ratio of 16. In addition shareholders get a dividend yielding 2.6% that has been grown by 13% annually over the last five years, which includes a huge 40% increase that was announced at the beginning of May.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2008	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2023
GP/A	28.4%	18.2%	25.7%	41.0%	36.1%	30.4%	30.6%	33.1%	36.7%	39.6%	40.0%	40.0%
Debt/A	38.5%	39.5%	42.4%	38.8%	35.0%	34.1%	33.7%	91.3%	86.1%	76.0%	75.0%	70.0%
Int. Cov.	---	---	9.3	30.0	26.5	19.0	19.6	5.8	9.1	13.1	13.0	13.0
Payout	21.6%	---	39.0%	20.4%	30.2%	49.8%	51.9%	67.1%	44.6%	36.0%	36.2%	40.9%
Std. Dev.	48.7%	49.3%	35.2%	36.0%	25.8%	20.1%	24.4%	36.4%	18.4%	20.7%	21.0%	20.0%

KLA-Tencor has strong fundamentals. Its gross profits to assets ratio is high and has been rising further over the last couple of years (higher services revenues, which requires less assets is a factor). KLA-Tencor has a relatively high liabilities to assets ratio, but the company’s balance sheet is very strong nevertheless. It holds \$2.8 billion in cash versus long term debt totaling just \$2.5 billion. A big portion of the liabilities consist of accounting items such as unearned revenues, accounts payable, deferred systems profit, etc. Due to cash levels being higher than long term debt the company has a lot of room to return cash to its owners or to grow inorganically.

KLA-Tencor is a key supplier to the biggest semiconductor companies and therefore a relevant part of this large industry that is extremely important to our modern way of life. KLA-Tencor is the market leader in the process control sector, its scale and size give it advantages over competitors when it comes to receiving big contracts, and through better economies of scale KLA-Tencor also has the ability to achieve higher margins than smaller peers.

KLA-Tencor’s business is cyclical, as lower spending by semiconductor manufacturers during downturns hurts KLA-Tencor substantially. Due to megatrends such as the IoT and big data, downturns could be less severe and prolonged as in the past.

Final Thoughts & Recommendation

KLA-Tencor is a fundamentally strong company that is a key player in the sector it is active in. Through acquisitions KLA-Tencor is growing inorganically in addition to the solid organic growth outlook. We expect KLA-Tencor to generate 12.6% annual total returns over the next 5 years. The company is a buy at current prices for investors looking for exposure to the semiconductor industry.

Total Return Breakdown by Year

