KLA-Tencor Corporation (KLAC)

Updated July 31st, 2018 by Jonathan Weber

Key Metrics

Current Price:	$106	**5 Year CAGR Estimate:**	15.6%	**Volatility Percentile:**	73.9%
Fair Value Price:	$131	**5 Year Growth Estimate:**	8.6%	**Momentum Percentile:**	51.2%
% Fair Value:	81%	**5 Year Valuation Multiple Estimate:**	4.2%	**Valuation Percentile:**	88.6%
Dividend Yield:	2.8%	**5 Year Price Target**	$197	**Total Return Percentile:**	92.9%

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 created in 1997 (through a merger between KLA Instruments and Tencor Instruments). It is headquartered in Milpitas, CA, and is currently valued at $17 billion.

KLA-Tencor reported its most recent quarterly results on July 30. The company earned $2.22 during the company's fiscal fourth quarter, an increase of 35% year over year. This strong earnings growth was possible thanks to a solid revenue growth rate of 14% over Q4 2017. KLA-Tencor reported earnings per share of $7.50 for fiscal 2018.

Growth on a Per-Share Basis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
EPS	-	$1.54	$4.91	$4.64	$3.21	$3.47	$2.98	$4.66	$5.94	$7.50	***$8.14***	***$12.30***
DPS	$0.60	$0.60	$1.00	$1.40	$1.60	$1.80	$2.00	$2.08	$2.14	$2.52	***$2.96***	***$4.95***

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 during fiscal 2018 the company reported strong record profits.

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 fourth quarter showing revenue growth of 14%.

Right now the majority of KLA-Tencor's revenues come from product sales, but service revenues are becoming increasingly important. 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. KLA-Tencor has also made several acquisitions in the past, which have added to its growth. The $3.4 billion takeover of Orbotech (ORBK) that was announced in March 2018 was the latest.

KLA-Tencor has reduced its share count meaningfully in the last couple of years, which has added to EPS growth as well. KLA-Tencor plans to increase its buyback activity going forward. Overall the company has solid growth prospects ahead.

Valuation Analysis

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Now	2024
Avg. P/E	---	20.9	7.9	9.9	15.9	18.2	22.8	13.6	14.1	13.6	***13.0***	***16.0***
Avg. Yld.	2.4%	1.9%	2.6%	3.0%	3.1%	2.8%	2.9%	3.3%	2.5%	2.9%	***2.8%***	***2.5%***

Shares of KLA-Tencor are valued at 13 times fiscal 2019's earnings right now. This is an inexpensive valuation relative to how shares were valued in the past and relative to the broad market's valuation.

Disclosure: This analyst has no position in the security discussed in this research report, and no plans to initiate one in the next 72 hours.

We forecast a substantial total return tailwind from multiple expansion going forward. Investors also get paid an attractive dividend yield of 2.9%.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2023
GP/A	18.2%	25.7%	41.0%	36.1%	30.4%	30.6%	33.1%	36.7%	39.6%	46.1%	***47.0%***	***49.0%***
Debt/A	39.5%	42.4%	38.8%	35.0%	34.1%	33.7%	91.3%	86.1%	76.0%	71.2%	***70.0%***	***70.0%***
Int. Cov.	---	9.3	30.0	26.5	19.0	19.6	5.8	9.1	13.1	14.7	***15.0***	***17.0***
Payout	---	39.0%	20.4%	30.2%	49.8%	51.9%	67.1%	44.6%	36.0%	33.6%	***36.4%***	***40.2%***
Std. Dev.	49.3%	35.2%	36.0%	25.8%	20.1%	24.4%	36.4%	18.4%	20.7%	24.7%	***23.0%***	***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. 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, 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.

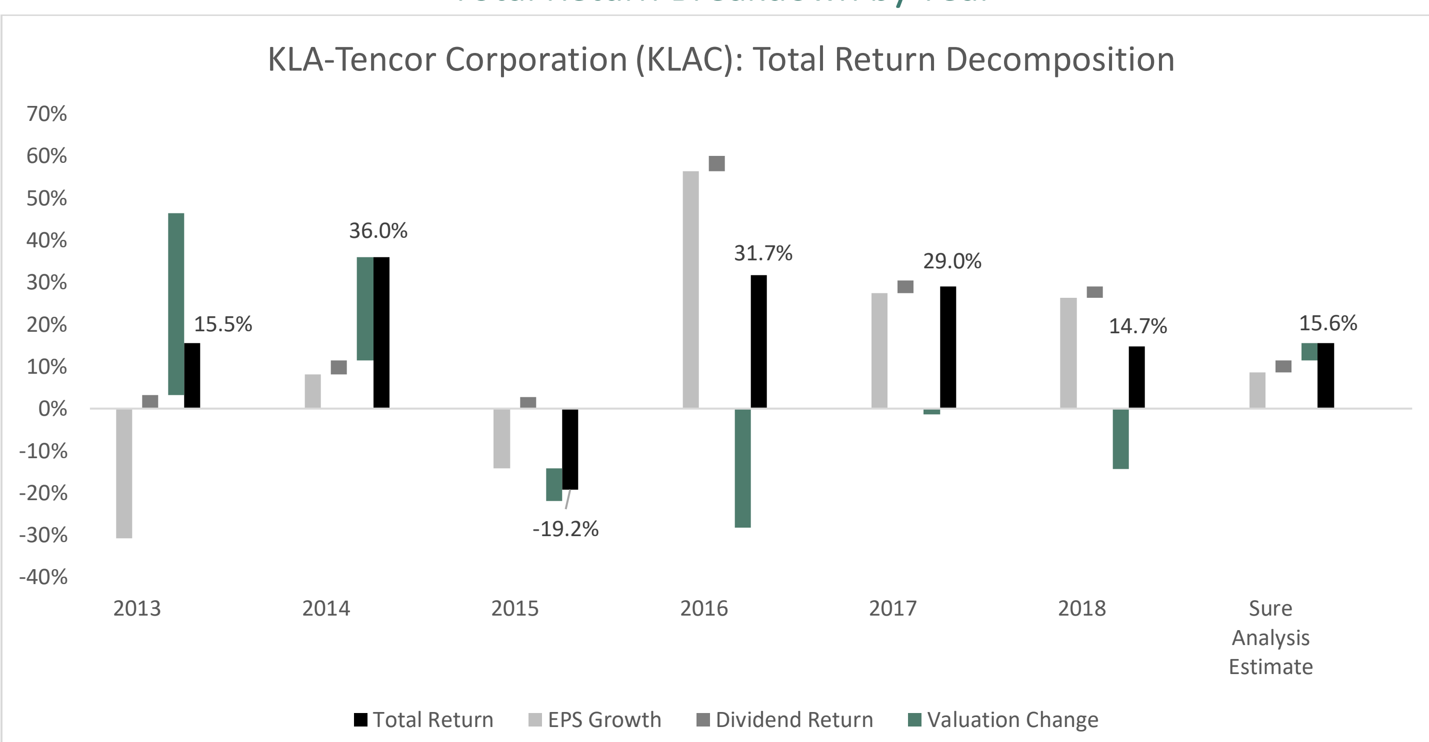
KLA-Tencor is a key supplier to the biggest semiconductor companies and therefore a relevant part of this large industry that is extremely important to our modern way of life. KLA-Tencor is the market leader in the process control sector. Its scale and size give it advantages over competitors when it 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 key player in an attractive industry. We believe that the growth outlook over the coming years is solid, and investors will benefit from attractive total returns going forward. KLA-Tencor looks like a solid buy at current prices.

Total Return Breakdown by Year



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