KLA-Tencor Corporation (KLAC)

Updated February 1st, 2019 by Jonathan Weber

Key Metrics

Current Price:	$107	**5 Year CAGR Estimate:**	12.7%	**Volatility Percentile:**	65.2%
Fair Value Price:	$114	**5 Year Growth Estimate:**	8.6%	**Momentum Percentile:**	58.3%
% Fair Value:	94%	**5 Year Valuation Multiple Estimate:**	1.3%	**Growth Percentile:**	83.8%
Dividend Yield:	2.8%	**5 Year Price Target**	$172	**Valuation Percentile:**	62.3%
Dividend Risk Score:	D	**Retirement Suitability Score:**	D	**Total Return Percentile:**	73.9%

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 $16.1 billion.

KLA-Tencor reported its second quarter (fiscal 2019) earnings results on January 29. The company reported revenues of $1.12 billion for the second quarter, which represents an increase of 14.8% compared to the prior year's second quarter. This revenue growth rate was significantly stronger than expected. KLA-Tencor's top line easily beat the analyst consensus. KLA-Tencor was able to grow both its Product segment revenues as well as its Services segment revenues, although the relative growth rate was stronger for the Services segment, at 25% year over year. This is a positive development, as services revenues are generally better for the company due to their lower capital intensity, higher predictability (recurring revenues), and higher margins.

KLA-Tencor generated earnings-per-share of $2.44 during the second quarter, which beat estimates by more than 10%, and which was 24% more than the earnings-per-share that KLA-Tencor was able to generate during the second quarter of fiscal 2018. KLA-Tencor has generated free cash flows of $260 million during the second quarter. Less than half of that was paid out to the company's owners in the form of dividends.

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***
Shares	171	168	167	167	165	165	158	156	157	156	***155***	***150***

KLA-Tencor has grown its earnings-per-share by 22% annually between 2010 and 2018, 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 2018 the company reported strong results, and during fiscal 2019 the company will most likely hit new record profits.

KLA-Tencor's earnings-per-share growth has historically come from a mix of revenue growth, margin improvements, and share repurchases. The revenue growth outlook remains strong, as sales during H1 of fiscal 2019 were higher than the company's sales during the second half of 2018. 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, and cloud computing.

These trends 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 plans to increase its buyback activity going forward, which is a positive. In total, the company's growth outlook is solid.

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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	***13.1***	***14.0***
Avg. Yld.	2.4%	1.9%	2.6%	3.0%	3.1%	2.8%	2.9%	3.3%	2.5%	2.9%	***2.8%***	***2.6%***

KLA-Tencor trades at roughly 13 times this year's net profits right now, which is a relatively low valuation in absolute terms. It also represents a small discount to our fair value estimate, as we believe that shares have upside potential towards a price to earnings multiple of 14. KLA-Tencor's dividend yield is higher than that of the broad market.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2024
Payout	---	39.0%	20.4%	30.2%	49.8%	51.9%	67.1%	44.6%	36.0%	33.6%	***36.4%***	***40.2%***

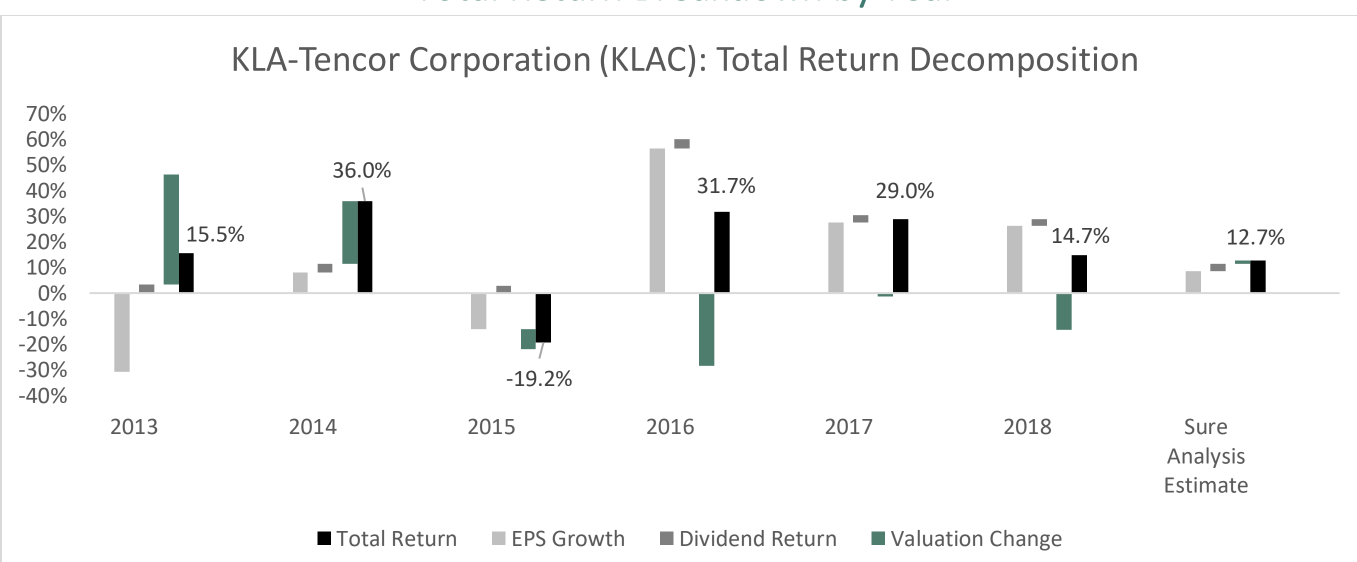
KLA-Tencor has not raised its dividend during the last financial crisis, but since then the dividend has been raised consistently. KLA-Tencor was not profitable during 2009, but the company chose to pay its dividend nevertheless. The payout ratio looks highly sustainable, although the cyclicality in KLA-Tencor's earnings could make the payout ratio rise substantially during a steep, global economic downturn.

KLA-Tencor is a key supplier to the largest 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.

Final Thoughts & Recommendation

KLA-Tencor is a key supplier to the very large semiconductor industry, and therefore benefits from megatrends that increase the global demand for chips. KLA-Tencor should be able to capitalize on these trends through growing earnings-per-share, and thanks to its above-average dividend yield and its below-average valuation the total return outlook is promising. We rate KLA-Tencor a buy and believe that this is a good way to benefit from growing semi demand.

Total Return Breakdown by Year



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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.

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Income Statement Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Revenue	1520	1821	3175	3172	2843	2929	2814	2984	3480	4037
Gross Profit	655	1005	1916	1842	1605	1696	1599	1821	2192	2589
Gross Margin	43.1%	55.2%	60.3%	58.1%	56.5%	57.9%	56.8%	61.0%	63.0%	64.1%
SG&A Exp.	415	361	369	373	388	385	407	379	389	443
D&A Exp.	136	87	86	92	88	83	81	67	58	63
Operating Profit	-131	314	1160	1016	730	772	661	960	1276	1537
Operating Margin	-8.6%	17.3%	36.5%	32.0%	25.7%	26.4%	23.5%	32.2%	36.7%	38.1%
Net Profit	-523	212	794	756	543	583	366	704	926	802
Net Margin	-34%	11.7%	25.0%	23.8%	19.1%	19.9%	13.0%	23.6%	26.6%	19.9%
Free Cash Flow	173	418	772	884	839	711	560	728	1041	1162
Income Tax	-79	79	316	218	147	152	68	154	247	654

Balance Sheet Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Total Assets	3610	3907	4676	5100	5287	5536	4826	4962	5532	5619
Cash & Equivalents	525	530	711	751	985	631	838	1108	1153	1404
Accounts Receivable	210	440	583	701	525	493	585	613	571	652
Inventories	370	402	576	651	634	656	618	699	733	932
Goodwill & Int. Ass.	478	445	414	383	361	363	347	340	368	374
Total Liabilities	1425	1660	1815	1785	1805	1867	4405	4273	4206	3999
Accounts Payable	63	108	143	139	116	103	103	107	147	169
Long-Term Debt	795	746	746	747	747	745	3190	3058	2930	2237
Shareholder's Equity	2184	2247	2861	3316	3482	3669	421	689	1326	1621
D/E Ratio	0.36	0.33	0.26	0.23	0.21	0.20	7.57	4.44	2.21	1.38

Profitability & Per Share Metrics

Year	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018
Return on Assets	-12.4%	5.6%	18.5%	15.5%	10.5%	10.8%	7.1%	14.4%	17.6%	14.4%
Return on Equity	-20.3%	9.6%	31.1%	24.5%	16.0%	16.3%	17.9%	127%	91.9%	54.4%
ROIC	-15.6%	7.1%	24.1%	19.7%	13.1%	13.5%	9.1%	19.1%	23.1%	19.8%
Shares Out.	171	168	167	167	165	165	158	156	157	156
Revenue/Share	8.93	10.52	18.64	18.64	16.80	17.42	17.19	19.04	22.10	25.65
FCF/Share	1.02	2.41	4.53	5.20	4.95	4.23	3.42	4.64	6.61	7.38

Note: All figures in millions of U.S. Dollars unless per share or indicated otherwise.