KLA-Tencor Corporation (KLAC)

Updated November 9th, 2019 by Jonathan Weber

Key Metrics

Current Price:	$148	**5 Year CAGR Estimate:**	9.7%	**Volatility Percentile:**	83.3%
Fair Value Price:	$140	**5 Year Growth Estimate:**	8.6%	**Momentum Percentile:**	99.6%
% Fair Value:	106%	**5 Year Valuation Multiple Estimate:**	-1.1%	**Growth Percentile:**	88.3%
Dividend Yield:	2.3%	**5 Year Price Target**	$212	**Valuation Percentile:**	28.9%
Dividend Risk Score:	B	**Retirement Suitability Score:**	D	**Total Return Percentile:**	39.8%

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, and has grown through a range of acquisitions since then. It is headquartered in Milpitas, CA, and is currently valued at $27 billion.

KLA-Tencor reported its first quarter (fiscal 2020) earnings results on October 31. The company reported revenues of $1.41 billion for the first quarter, which represents an increase of 29.4% compared to the prior year's quarter. This revenue growth rate was stronger than what the analyst community had expected, as KLA-Tencor's top line beat the analyst consensus by $60 million. KLA-Tencor's Product segment revenue grew 29% year-over-year, while the Services segment grew at an even stronger pace of 35% year-over-year. This is positive, as services revenues are generally better for the company due to their lower capital intensity, higher predictability, and higher margins.

KLA-Tencor generated earnings-per-share of $2.48 during the first quarter, which beat estimates by $0.28, and which was up by a massive 39% compared to the earnings-per-share that KLA-Tencor was able to generate during the previous year's quarter. KLA-Tencor generated cash flows of $350 million during the first quarter.

Growth on a Per-Share Basis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
EPS	$1.54	$4.91	$4.64	$3.21	$3.47	$2.98	$4.66	$5.94	$7.50	$8.46	***$10.01***	***$15.12***
DPS	$0.60	$1.00	$1.40	$1.60	$1.80	$2.00	$2.08	$2.14	$2.52	$3.00	***$3.40***	***$5.55***
Shares[1]	168	167	167	165	165	158	156	157	156	156	***155***	***150***

KLA-Tencor grew its earnings-per-share by ~20% annually between 2010 and 2019, although growth has been quite uneven. During 2009 the company reported net losses, and it has 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 has 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 KLA-Tencor has been able to grow its sales considerably during the last couple of quarters, especially for its Services segment. 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 recurring 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, which fuels their demand for KLA-Tencor's products. KLA-Tencor has also made several acquisitions in the past, which have added to its growth, such as the $3.4 billion takeover of Orbotech that closed in early 2019. KLA-Tencor also plans to increase its buybacks, which will benefit its earnings-per-share.

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[1] In Millions

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Valuation Analysis

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	Now	2025
Avg. P/E	20.9	7.9	9.9	15.9	18.2	22.8	13.6	14.1	13.6	14.4	***14.8***	***14.0***
Avg. Yld.	1.9%	2.6%	3.0%	3.1%	2.8%	2.9%	3.3%	2.5%	2.9%	2.5%	***2.3%***	***2.6%***

KLA-Tencor trades at roughly 15 times this year's net earnings, which is not an overly high valuation in absolute terms. It nevertheless represents a small premium to our fair value estimate, as we believe that shares have downside potential towards a price to earnings multiple of 14. KLA-Tencor offers an average dividend yield at current prices.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2025
Payout	39.0%	20.4%	30.2%	49.8%	51.9%	67.1%	44.6%	36.0%	33.6%	35.5%	***34.0%***	***36.7%***

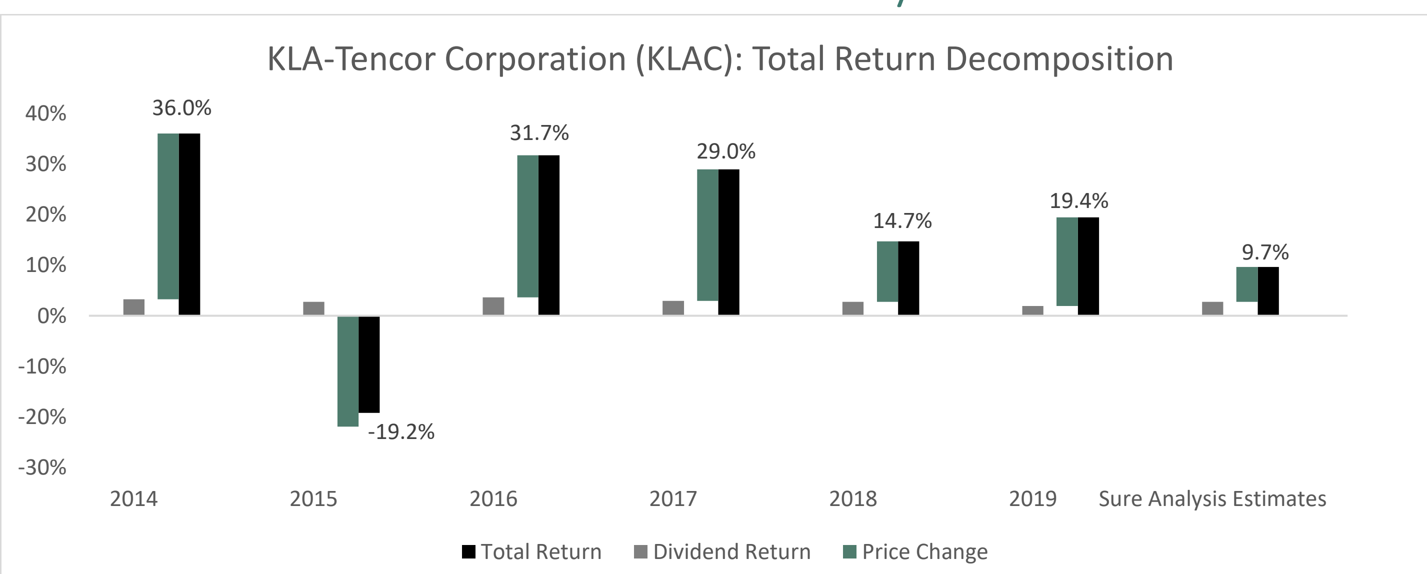
KLA-Tencor did not raise its dividend during the last financial crisis, but since then the dividend has been raised very consistently. KLA-Tencor was not profitable during 2009, but the company chose to maintain its dividend nevertheless. The payout ratio looks highly sustainable, although the cyclicality 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

As an important supplier to the very large semiconductor industry, KLA-Tencor benefits from megatrends that increase the global demand for chips. KLA-Tencor should be able to capitalize on these trends by growing its earnings-per-share, and despite the fact that shares trade slightly above fair value, the total return outlook is not bad. We rate KLA-Tencor a hold at current prices, and a potential buy at or below fair value.

Total Return Breakdown by Year



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Income Statement Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Revenue	1821	3175	3172	2843	2929	2814	2984	3480	4037	4569
Gross Profit	1005	1916	1842	1605	1696	1599	1821	2194	2591	2700
Gross Margin	55.2%	60.3%	58.1%	56.5%	57.9%	56.8%	61.0%	63.0%	64.2%	59.1%
SG&A Exp.	361	369	373	388	385	407	379	388	442	599
D&A Exp.	87	86	92	88	83	81	67	58	63	233
Operating Profit	314	1160	1016	730	772	661	960	1279	1540	1389
Operating Margin	17.3%	36.5%	32.0%	25.7%	26.4%	23.5%	32.2%	36.7%	38.1%	30.4%
Net Profit	212	794	756	543	583	366	704	926	802	1176
Net Margin	11.7%	25.0%	23.8%	19.1%	19.9%	13.0%	23.6%	26.6%	19.9%	25.7%
Free Cash Flow	418	772	884	839	711	560	728	1041	1162	1022
Income Tax	79	316	218	147	152	68	154	247	654	121

Balance Sheet Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Total Assets	3907	4676	5100	5287	5536	4826	4962	5532	5639	9009
Cash & Equivalents	530	711	751	985	631	838	1108	1153	1404	1016
Accounts Receivable	440	583	701	525	493	585	613	571	652	990
Inventories	402	576	651	634	656	618	699	733	932	1263
Goodwill & Int. Ass.	445	414	383	361	363	347	340	368	374	3773
Total Liabilities	1660	1815	1785	1805	1867	4405	4273	4206	4018	6331
Accounts Payable	108	143	139	116	103	103	107	147	169	202
Long-Term Debt	746	746	747	747	745	3190	3058	2930	2237	3423
Shareholder's Equity	2247	2861	3316	3482	3669	421	689	1326	1621	2659
D/E Ratio	0.33	0.26	0.23	0.21	0.20	7.57	4.44	2.21	1.38	1.29

Profitability & Per Share Metrics

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019
Return on Assets	5.6%	18.5%	15.5%	10.5%	10.8%	7.1%	14.4%	17.6%	14.4%	16.1%
Return on Equity	9.6%	31.1%	24.5%	16.0%	16.3%	17.9%	127%	91.9%	54.4%	54.9%
ROIC	7.1%	24.1%	19.7%	13.1%	13.5%	9.1%	19.1%	23.1%	19.8%	23.6%
Shares Out.	168	167	167	165	165	158	156	157	156	156
Revenue/Share	10.52	18.64	18.64	16.80	17.42	17.19	19.04	22.10	25.65	29.11
FCF/Share	2.41	4.53	5.20	4.95	4.23	3.42	4.64	6.61	7.38	6.51

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