KLA-Tencor Corporation (KLAC)

Updated August 18th, 2020 by Jonathan Weber

Key Metrics

Current Price:	$212	**5 Year CAGR Estimate:**	5.8%	**Market Cap:**	$33B
Fair Value Price:	$171	**5 Year Growth Estimate:**	8.5%	**Ex-Dividend Date:**	11/10/20[1]
% Fair Value:	124%	**5 Year Valuation Multiple Estimate:**	-4.2%	**Dividend Payment Date:**	12/01/20[2]
Dividend Yield:	1.7%	**5 Year Price Target**	$257	**Years Of Dividend Growth:**	11
Dividend Risk Score:	C	**Retirement Suitability Score:**	D	**Last Dividend Increase:**	5.9%

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, and has grown through a range of acquisitions since then. The company is headquartered in Milpitas, CA.

KLA-Tencor reported its fourth quarter (fiscal 2020) earnings results on August 3. The company reported revenues of $1.5 billion for the quarter, which represents an increase of 16% 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 $40 million. KLA-Tencor's Product segment revenue grew 17% year-over-year, while the Services segment grew at a pace of 11% year-over-year.

KLA-Tencor generated earnings-per-share of $2.73 during the fourth quarter, which beat estimates by $0.31, and which was up by a massive 53% compared to the previous year's quarter. The coronavirus crisis is not having a big impact on KLA-Tencor so far, as fiscal 2020 was a new record year for the company. The outlook for fiscal 2021 is even better.

Growth on a Per-Share Basis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
EPS	$4.91	$4.64	$3.21	$3.47	$2.98	$4.66	$5.94	$7.50	$8.46	$10.35	***$11.40***	***$17.14***
DPS	$1.00	$1.40	$1.60	$1.80	$2.00	$2.08	$2.14	$2.52	$3.00	$3.40	***$3.60***	***$5.80***
Shares[3]	167	167	165	165	158	156	157	156	156	156	***155***	***150***

KLA-Tencor grew its earnings-per-share by ~20% annually between 2010 and 2020, 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 2019 the company reported strong results, and during fiscal 2020 the company 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. 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 should 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. Global memory markets recovering from a period of low prices helps KLA-Tencor. 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 last year.

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[1] Estimated date
[2] Estimated date
[3] In Millions

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Valuation Analysis

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	Now	2026
Avg. P/E	7.9	9.9	15.9	18.2	22.8	13.6	14.1	13.6	14.4	18.7	***18.6***	***15.0***
Avg. Yld.	2.6%	3.0%	3.1%	2.8%	2.9%	3.3%	2.5%	2.9%	2.5%	1.8%	***1.7%***	***2.3%***

KLA-Tencor trades at more than 18 times this year's net earnings, which is a rather expensive valuation compared to how shares were valued in the past. It represents a premium to our fair value estimate, as we believe that shares have downside potential towards a price to earnings multiple of 15.

Safety, Quality, Competitive Advantage, & Recession Resiliency

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2026
Payout	20.4%	30.2%	49.8%	51.9%	67.1%	44.6%	36.0%	33.6%	35.5%	32.9%	***31.6%***	***33.8%***

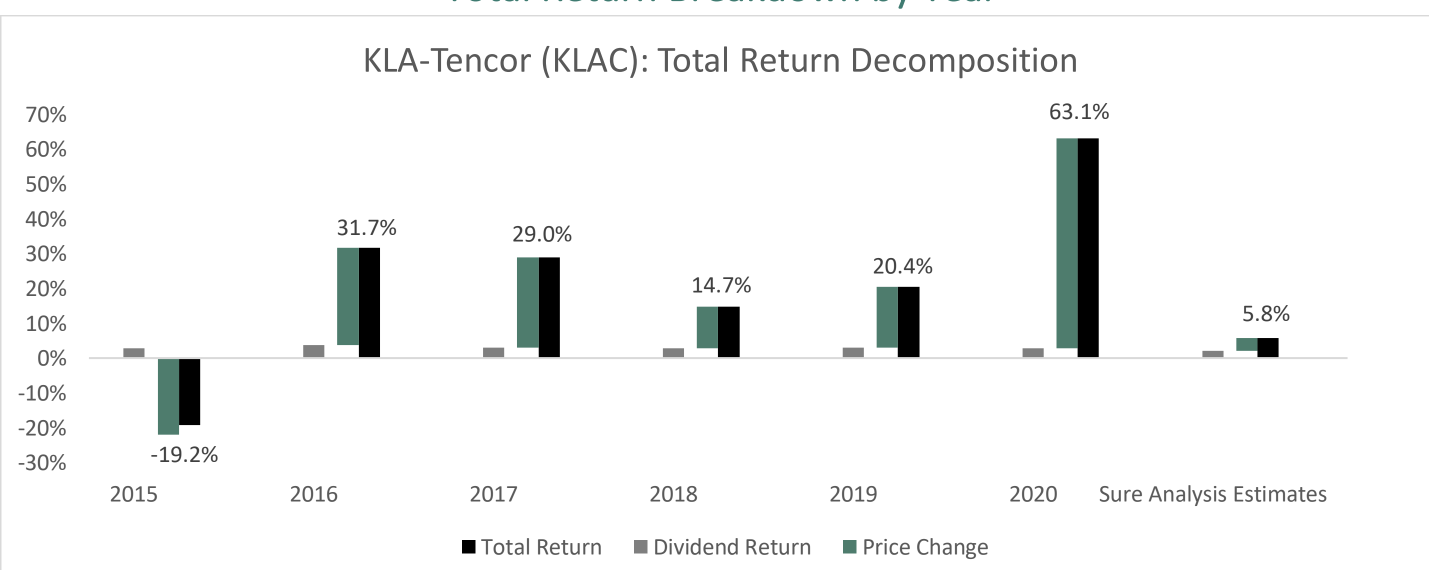
KLA-Tencor did not raise its dividend during the last financial crisis, but since then the dividend has been raised very consistently. KLA-Tencor was not profitable during 2009, but the company chose to maintain its dividend nevertheless. The payout ratio looks highly sustainable, although the cyclicality in KLA-Tencor's earnings could make the payout ratio rise substantially during another global economic downturn that hurts chip markets massively.

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 market downturns hurts KLA-Tencor.

Final Thoughts & Recommendation

As an important supplier to the very large semiconductor industry, KLA-Tencor benefits from megatrends that increase global demand for chips, such as the Internet of Things. KLA-Tencor should be able to capitalize on these trends by growing its earnings-per-share, and despite the fact that shares trade above fair value, the total return outlook is not especially 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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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	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Revenue	3,175	3,172	2,843	2,929	2,814	2,984	3,480	4,037	4,569	5,806
Gross Profit	1,916	1,842	1,605	1,696	1,599	1,821	2,194	2,591	2,700	3,357
Gross Margin	60.3%	58.1%	56.5%	57.9%	56.8%	61.0%	63.0%	64.2%	59.1%	57.8%
SG&A Exp.	369	373	388	385	407	379	388	442	599	734
D&A Exp.	86	92	88	83	81	67	58	63	233	348
Operating Profit	1,160	1,016	730	772	661	960	1,279	1,540	1,389	1,759
Operating Margin	36.5%	32.0%	25.7%	26.4%	23.5%	32.2%	36.7%	38.1%	30.4%	30.3%
Net Profit	794	756	543	583	366	704	926	802	1,176	1,217
Net Margin	25.0%	23.8%	19.1%	19.9%	13.0%	23.6%	26.6%	19.9%	25.7%	21.0%
Free Cash Flow	772	884	839	711	560	728	1,041	1,162	1,022	1,626
Income Tax	316	218	147	152	68	154	247	654	121	102

Balance Sheet Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Total Assets	4,676	5,100	5,287	5,536	4,826	4,962	5,532	5,639	9,009	9,280
Cash & Equivalents	711	751	985	631	838	1,108	1,153	1,404	1,016	1,234
Accounts Receivable	583	701	525	493	585	613	571	652	990	1,107
Inventories	576	651	634	656	618	699	733	932	1,263	1,311
Goodwill & Int. Ass.	414	383	361	363	347	340	368	374	3,773	3,437
Total Liabilities	1,815	1,785	1,805	1,867	4,405	4,273	4,206	4,018	6,331	6,599
Accounts Payable	143	139	116	103	103	107	147	169	202	264
Long-Term Debt	746	747	747	745	3,190	3,058	2,930	2,237	3,423	3,470
Shareholder's Equity	2,861	3,316	3,482	3,669	421	689	1,326	1,621	2,659	2,665
D/E Ratio	0.26	0.23	0.21	0.20	7.57	4.44	2.21	1.38	1.29	1.30

Profitability & Per Share Metrics

Year	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020
Return on Assets	18.5%	15.5%	10.5%	10.8%	7.1%	14.4%	17.6%	14.4%	16.1%	13.3%
Return on Equity	31.1%	24.5%	16.0%	16.3%	17.9%	127%	91.9%	54.4%	54.9%	45.7%
ROIC	24.1%	19.7%	13.1%	13.5%	9.1%	19.1%	23.1%	19.8%	23.6%	19.9%
Shares Out.	167	167	165	165	158	156	157	156	156	156
Revenue/Share	18.64	18.64	16.80	17.42	17.19	19.04	22.10	25.65	29.11	36.75
FCF/Share	4.53	5.20	4.95	4.23	3.42	4.64	6.61	7.38	6.51	10.29

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