

SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549

FORM 10-K

(MARK ONE)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED JUNE 30, 2000

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES  
EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_

COMMISSION FILE NO. 0-9992

KLA-TENCOR CORPORATION  
(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE 04-2564110  
(STATE OR OTHER JURISDICTION OF (I.R.S. EMPLOYER IDENTIFICATION NUMBER)  
INCORPORATION OR ORGANIZATION)

160 RIO ROBLES, SAN JOSE, CALIFORNIA 95134  
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES) (ZIP CODE)

REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE: (408) 875-6000

SECURITIES REGISTERED PURSUANT TO SECTION 12(b) OF THE ACT:

TITLE OF EACH CLASS NAME OF EACH EXCHANGE ON WHICH REGISTERED  
NONE NONE

SECURITIES REGISTERED PURSUANT TO SECTION 12(g) OF THE ACT:  
COMMON STOCK, \$0.001 PAR VALUE  
COMMON STOCK PURCHASE RIGHTS  
(TITLE OF CLASS)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

The aggregate market value of the voting stock held by non-affiliates of the registrant based upon the closing price of the registrant's stock, as of September 20, 2000, was \$9,992,701,796. Shares of common stock held by each officer and director and by each person or group who owns 5% or more of the outstanding common stock held by each officer and director and by each person or group who owns 5% or more of the outstanding common stock have been excluded in that such persons or groups may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

The registrant had 187,436,376 shares of Common Stock outstanding as of September 20, 2000.

Portions of the Proxy Statement for the Annual Meeting of Stockholders ("Proxy Statement") to be held on November 10, 2000, and to be filed pursuant to Regulation 14A within 120 days after registrant's fiscal year ended June 30, 2000, are incorporated by reference into Part III of this Report.

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FORWARD-LOOKING STATEMENTS

This report contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. All statements included in or incorporated by reference in this Annual Report on Form 10-K, other than statements of historical fact, are forward-looking statements. Such forward-looking statements include, among others, those statements regarding the future results of our operations; technological trends in the semiconductor industry; our future product offerings and product features; anticipated revenue from various domestic and international regions; success of our product offerings; completion of backlog; creation of development and engineering programs for research and development; the completion of any acquisitions of third parties, or the technology or assets thereof; benefits received from any acquisitions; construction of our new Livermore, California campus; the outcome of any litigation to which we are a party; results of our investment in leading edge technologies, enhancements of current products and strategic acquisitions; our future income tax rate; sufficiency of our existing cash balance, investments and cash generated from operations to meet our liquidity and working capital requirements; and the effects of hedging transactions.

Our actual results may differ significantly from those projected in the forward-looking statements in this report. Factors that might cause or contribute to such differences include, but are not limited to, those discussed in the "Risk Factors" section in Item 7, "Management's Discussion and Analysis of Results of Operations and Financial Condition" in this Annual Report on Form 10-K. You should carefully review these risks and also review the risks described in other documents we file from time to time with the Securities and Exchange Commission, including the Quarterly Reports on Form 10-Q that we will file in fiscal 2001. You are cautioned not to place undue reliance on these forward-looking statements. We undertake no obligation to update forward-looking statements.

## ITEM 1. BUSINESS

### THE COMPANY

KLA-Tencor Corporation ("KLA-Tencor") is the world's leading supplier of process control and yield management solutions for the semiconductor and related microelectronics industries. Our comprehensive portfolio of products, software, analysis, services and expertise is designed to help integrated circuit manufacturers manage yield throughout the entire wafer fabrication process - from research and development to final mass production yield analysis.

We offer a broad spectrum of products and services that are used by every major semiconductor manufacturer in the world. These customers turn to us for in-line wafer defect

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monitoring; reticle and photomask defect inspection; CD SEM metrology; wafer overlay; film and surface measurement; and overall yield and fab-wide data analysis. These advanced products, coupled with our unique yield management consulting practice, allow us to deliver the complete yield management solutions customers need to accelerate their yield learning rates, reduce their yield excursion risks and adopt industry-leading yield management practices.

KLA-Tencor Corporation was formed in April 1997 through the merger of KLA Instruments Corporation and Tencor Instruments, two long-time leaders in the semiconductor equipment industry, each with over 20 years of experience. KLA Instruments Corporation was incorporated in Delaware in July 1975 and Tencor Instruments in California in 1976. Effective April 30, 1997, Tencor Instruments merged into a wholly owned subsidiary of KLA Instruments Corporation. Immediately following this merger, KLA Instruments Corporation changed its name to KLA-Tencor Corporation.

During fiscal 2000, we acquired ACME Systems, Inc., FINLE Technologies, Inc. and Fab Solutions, a division of Object Space, Inc. For further details, see the section below entitled "Acquisitions."

### INDUSTRY

#### General Background

The semiconductor fabrication process begins with a bare silicon wafer - a round disk, six, eight or twelve inches in diameter, about as thick as a credit card and gray in color. The process of manufacturing wafers is in itself a high technology activity, involving the creation of large ingots of silicon by pulling them out of a vat of molten silicon. The ingots are then sliced into wafers and polished to a mirror finish on one surface, upon which the circuits are made.

The fabrication of an integrated circuit ("IC" or "chip") is accomplished by depositing a series of film layers upon a silicon wafer that act as conductors, semiconductors or insulators. The deposition of these film layers is interspersed with numerous other process steps that create circuit patterns, remove portions of the film layers, and perform other functions such as heat treatment, measurement and inspection. Most advanced chip designs require well over 300 individual steps, many of which are performed multiple times. Most chips consist of two main structures: the lower structure, typically consisting of transistors or capacitors, which performs the "smart" functions of the chip, and the upper structure, typically consisting of "interconnect" circuitry, which connects the components in the lower structure.

#### Current Trends

Several factors inherent in the semiconductor industry drive the critical need for comprehensive process control and yield management solutions. Among the most significant of these factors are: increasing device complexity, shrinking geometries, reduced product life cycles for the IC's being manufactured, and increased competition. Our key activities during fiscal year 2000

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involved development of process control and yield management equipment for smaller feature sizes, 300mm wafers and copper-based devices.

Today, manufacturers of advanced integrated circuits require systems capable of measurements smaller than 0.25 micron (approximately 1/300 the thickness of a human hair). At the same time, advanced manufacturing facilities are producing integrated circuits on silicon wafers measuring 300 millimeter in diameter. The complexity of the sub-micron semiconductor manufacturing process combined with the recent transition from aluminum to copper as the primary interconnect material in integrated circuits has caused dramatic growth in the demand for increasingly precise manufacturing process monitors. As a result, total yield management solutions play a more significant role in the semiconductor manufacturing process than in the past. With our portfolio of applications-focused technologies and our dedicated yield consulting expertise, we are in a unique position to be the single source for comprehensive yield management solutions.

The continuing evolution of semiconductor devices to smaller line width geometries and more complex multi-level circuitry has significantly increased the cost and the performance requirements of the capital equipment used to manufacture these devices. Construction of an advanced wafer fabrication facility can cost over \$1 billion, a substantial increase over the cost of prior-generation facilities. As a result, there is a demand for increased productivity and higher returns from manufacturing equipment. Because our process monitoring and yield management equipment typically represent only a small percentage of the total investment required to build a fabrication facility, our customers are able to better leverage these increasingly expensive facilities and significantly improve their returns on investment.

#### Our Process Control and Yield Management Solutions

Accelerating the yield ramp and maximizing the production yields of high-performance devices are key goals of modern semiconductor manufacturing. Achieving higher yields faster and with higher performance characteristics increases the revenue a manufacturer can obtain from each semiconductor wafer. KLA-Tencor systems are used to analyze product and process quality all at critical points in the IC manufacturing process and provide feedback to our customers so that fabrication problems can be identified, addressed and eliminated. This ability to locate the source of defects and other process issues, as well as contain them, enables semiconductor manufacturers to increase yields and device value, thus maximizing return on investment and lowering manufacturing costs.

As design rules decrease, yields become more sensitive to the size and density of defects, while device performance characteristics become more sensitive to such parameters as linewidth, film thickness variation, and other factors. Semiconductor manufacturers use process monitoring and yield management systems to improve yields and device performance by identifying defects and other anomalies and analyzing them to determine process problems. After corrective action has been taken, subsequent results can be monitored to ensure that the problem has been contained. This monitoring and analysis takes place at various points in the fabrication process as wafers move through a production cycle.

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The following are some of the methods used to accelerate yields and optimize device performance, all of which require the capture and analysis of data gathered through many measurements:

**Engineering analysis:** This method of analysis is performed off-line from the manufacturing process to identify, analyze and locate the source of defects or other manufacturing process issues. Engineering analysis equipment operates with very high sensitivity to enable comprehensive analysis of wafers. Because this method operates off of the manufacturing line, high operational speeds are not required.

**In-line monitoring:** This method of analysis is used to review the status of integrated circuits during production. Information generated is used to determine whether the fabrication process steps are within required tolerances. It is also used to make any necessary real-time process adjustments before wafer lots move to subsequent process stations. Because information related to defects is needed quickly, in-line monitoring requires both high throughput and high sensitivity.

Pass/fail tests: This method of analysis may be used at several different points in the manufacturing process to evaluate whether products meet performance specifications.

The most significant opportunities for yield and device performance improvement generally occur when production is started at new factories and when chips or wafers are first built. Equipment that helps a manufacturer quickly increase new product yields and optimize device performance enables the manufacturer to offer these new products in high volumes early in the product life cycle - the time when they are likely to generate the greatest profits.

KLA-Tencor is the leader in the design, manufacture, marketing and service of process monitoring and yield management systems for the semiconductor industry. Our technical expertise and understanding of customer needs enable us to provide unique yield management solutions and one of the broadest lines of process monitoring and yield management function systems available in the semiconductor industry. Our systems are used to analyze product and process quality at critical points in the IC manufacturing process and to provide feedback to our customers that can be used to identify, address, contain and eliminate fabrication problems. As a result, our customers may increase yields and device value, and may maximize their return on investment and lower their manufacturing costs.

## PRODUCTS

We market and sell products to all major semiconductor IC manufacturers and semiconductor wafer manufacturers worldwide. We combine our hardware - consisting of patterned and unpatterned wafer inspection, optical overlay and e-beam metrology, reticle inspection, film measurement and surface metrology tools - with analysis and classification software, into process module control ("PMC") solutions. We offer a PMC solution optimized for each of the

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manufacturing process cells - lithography, etch, deposition and chemical mechanical planarization (CMP) - used in IC production.

Our registered trademarks are: "KLA", "Tencor", "Surfscan", "KLA-Tencor", "Klarity" and "Quantox". "SEMSpec", "SP1", "CRS", "PMC-Net", "IMPACT", "SmartGallery", "pQC", "STARlight" and "iSupport" are among the other trademarks we maintain.

## Wafer Inspection

Our inspection tools are used to detect, count, classify and characterize particles and pattern defects on wafers in off-line engineering applications and in-line at various stages during the semiconductor and wafer manufacturing processes. Wafer defect detection systems inspect wafers as they move between processing steps and detect defects and contaminants on both bare silicon and patterned silicon. We pioneered the market for automated defect inspection of semiconductor wafers over a decade ago. The KLA-Tencor solution includes all the tools necessary for our customers to detect, correlate and analyze defects and to determine and correct the cause of defects.

In 1992, we introduced the 2lxx inspection system series, which provided the sensitivity required for the logic and repeating array portions of memory devices, as well as for microprocessors and other logic devices. Each new model of the 2lxx series has provided greater sensitivity and throughput than its predecessor. In 1997, we introduced the model 2138, a new patterned wafer inspection system combining an ultra-broadband illumination source and significantly improved brightfield optics. In 1999, we introduced the model 2139, which extended the capability of the 2lxx product line to 0.18-micron processes and incorporated additional sensitivity and ease-of-use enhancements. In July of 2000, we introduced the 2350, the first ultraviolet ("UV") inspection system to feature ultra-broadband brightfield illumination--enabling the resolution of circuit patterns and defects for 0.13-micron and smaller design rules. The 2350 delivers a two-fold increase in throughput over the previous generation 2lxx platform.

In 1995, we introduced the AIT inspection system, a platform designed with high throughput and low cost of ownership ("CoO") for fast and accurate feedback on process tool performance as well as advanced line monitoring for films, chemical mechanical planarization ("CMP"), and non-critical etch and photo modules. The AIT uses darkfield technology, which is a low-angle illumination technique particularly effective for detecting defects on planar surfaces such as post-CMP wafers. In 1998, we introduced the AIT II, which expanded on the capability of the AIT through increased sensitivity and

throughput. In July of 2000, we introduced the AIT III, providing high-throughput inspection with the increased sensitivity needed for 0.13-micron and smaller design rules.

In 1991, we introduced the SEMSpec(TM) system series, which provide a fully automatic e-beam defect inspection system. Scanning Electron Microscopes ("SEM") use an electron beam to image and measure surface features on a semiconductor wafer at a much higher resolution than images captured by optical microscopes. As the industry moves deeper into the sub-0.18-micron realm, SEM-based inspection becomes mandatory for accelerating yield ramps. In 1999, we developed the eS20, which has performance enhancements compared to the previous generation of e-

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beam defect inspection systems. In July of 2000, we introduced the eS20XP, which delivers further improvements in sensitivity while increasing throughput.

In 1997, we introduced the Surfscan SP1(TM), which is used for bare wafer qualification, process monitoring and equipment monitoring. It provides the high sensitivity, fast throughput and low CoO required in a production environment, and is used in virtually all semiconductor manufacturing processes. The SP1 TBI ("Triple Beam Illumination") was introduced in 1998 and was designed with additional optical configurations needed to detect sub-micron defects on metal films and rough surfaces while still providing sensitivity below 0.1 micron on polished silicon. It is also used for detecting defects on non-uniform films, a critical requirement for CMP applications. In November of 1999, we introduced a Surface Nanotopography Measurement capability for the SP1, enhancing lithography and CMP process monitoring for 0.13-micron process development.

In 1999, we became the first to automate after-develop inspection ("ADI") for macro defects with the introduction of the 2401 macro defect inspection system. Designed to replace inefficient manual macro ADI, the 2401 is the industry's first fully automated inspection system able to detect and classify front-end macro lithographic defects, which are 50 microns and larger in size. Current manual ADI methods may capture only 20 percent of photo-related defects as a result of wafer complexity, background patterning noise and human boredom and fatigue. In contrast, the 2401 captures more than 90 percent of all critical macro ADI defects, while providing comprehensive defect classification and yield information to dramatically reduce scrap and enable continuous process improvements.

Our defect review capability includes optical confocal technology as well as e-beam for higher sensitivity. In 1995, we introduced the CRS(TM) optical review system, which offers high throughput and low CoO. In 2000, we introduced the eV300 defect review system, an advanced, automated SEM designed to gather defect excursion information, analyze and report the results with the improved sensitivity required at smaller design rules. The eV300 supplements optical review by providing topographical information, enabling more accurate defect classification than can be achieved by optical review systems alone.

We offer analysis systems comprised of hardware and software to translate raw inspection data into patterns that reveal process problems. Our software productivity and analysis systems capture, store and analyze data collected by inspection, measurement and test equipment to show defect trends and help semiconductor manufacturers develop long-term yield improvement strategies. In November of 1999, we introduced our PMC-Net(TM) software, the industry's first software solution to connect all yield, process and test-floor related data into a single, automated, customizable and easy-to-use data collection, analysis and reporting system. PMC-Net fully automates the yield management and process control functions throughout the fab, enabling semiconductor manufacturers to speed time to market and time to profit. The PMC-Net product line was enhanced in fiscal 2000 with a series of strategic acquisitions, including Taiwan-based ACME Systems, Inc., the world's leading supplier of yield correlation software; FINLE Technologies, the industry leader in simulation software to reduce lithography development time and cost; and Fab Solutions, a leading provider of advanced process control ("APC") software solutions for semiconductor manufacturing.

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In 1997, we introduced IMPACT(TM) automated defect classification ("ADC"), enabling semiconductor manufacturers to utilize software systems both within and between fabrication facilities to accelerate the ramp to higher

process yields. With IMPACT ADC, semiconductor manufacturers can develop a defect classification recipe on one system and then export it to any other system or fabrication facility running identical processes. In November of 1999, we introduced IMPACT XP, incorporating improved optics support and a new SmartGallery(TM) setup tool, which reduces the setup time associated with ADC implementation in fabs by as much as 70 percent. This is a critical requirement, particularly for foundries and application specific integrated circuit ("ASIC") manufacturers, who specialize in short runs of multiple products. In July of 2000, we introduced IMPACT SEM XP, bringing to our eV300 SEM review tool the same production-proven ADC capabilities already implemented on our high-resolution optical wafer inspection platforms. With these new capabilities, customers can optimize the eV300 for use in classifying and reviewing the extremely small defects associated with advanced semiconductor manufacturing processes, including 0.13-micron and smaller design rules, thus dramatically reducing the CoO of SEM review.

"Run-time classification" ("RTC") capability, first introduced on both the AIT II and 2139 products, continues to be a critical feature on all of our next-generation optical inspection tools, including the AIT III and 2350. RTC provides classification and binning of defect types in real time during inspection, thus providing better organized information in less time and at a lower cost.

All of these tools and software--together with our yield management expertise--comprise our integrated Defect Reduction and Control Solution. This integrated yield management approach provides semiconductor device manufacturers with a comprehensive tool set providing accelerated attainment of yield goals.

#### Optical Overlay and E-Beam Metrology

The critical dimension ("CD") of a semiconductor device refers to a circuit line, element, or feature that must be manufactured to tight specifications. Semiconductor circuits can be very sensitive to the widths of their features. Even small variations can affect the speed of the circuit, or whether the circuit works at all. Control of linewidth errors is critical to the manufacturing process. Our CD SEM metrology systems measure selected linewidth features on a chip, thus enabling control of the manufacturing process. Decreasing linewidths, larger die sizes and additional layers also affect the tolerances for layer-to-layer matching ("Overlay"). Overlay mis-registration errors are a crucial cause of yield loss. Our metrology systems measure the alignment between different layers of the semiconductor device.

In 1999, we introduced the 8100XP CD SEM, designed to address the new metrology challenges associated with manufacturing ICs with 0.18-micron and smaller design rules. Providing maximum flexibility for both photomask manufacturers and advanced lithography development fabs, the 8100XP is the only CD SEM that can measure both reticles and wafers without requiring any hardware or software changeover. In November of 1999, we enhanced our 8100 CD SEM family with our new Pattern Quality Confirmation ("pQC"(TM)) software. With pQC, the 8100 CD SEM family combines in-line, real-time metrology with process inspection, enabling the detection of systematic lithography and etch related problems that can go undetected by traditional CD SEM

measurements. In June of 2000, we introduced our latest generation CD SEMs, the 8200 series (for 200 mm wafers) and the 8300 series (for 300 mm wafers). These tools combine high throughput, advanced imaging, superior measurement precision and enhanced productivity capabilities in a new Windows NT-based platform.

To address the challenges presented by overlay mis-registration, we offer the 5000 series metrology systems for overlay measurement. The measurement algorithms for the 5000 series are more tolerant of process and substrate reflectivity variations than other optical systems. Based on these measurements, users can fine-tune the stepper program to compensate for these errors and improve process yield. In 1999, we introduced the 5300 overlay system, which has performance enhancements compared to the previous generation of tools and is designed to handle both 200 mm and 300 mm wafers.

#### Reticle Inspection

Our reticle inspection systems look for possible defects that could be transmitted to the design pattern on the wafer. Reticles are high precision quartz plates that contain microscopic images of electronic circuits. These reticles are used to transfer circuit patterns onto wafers to fabricate ICs. Error-free reticles are the first step in ensuring high yields in the manufacturing process because defects in reticles can be replicated on wafers.



We pioneered the market for automated inspection of reticles and photomasks for the semiconductor manufacturing industry over two decades ago and continue to be a market leader.

Our 3XX product family incorporates both a reference database generator and a data preparation system, which give full die-to-database functionality to the inspection. This permits inspection against the ideal reticle pattern as specified by the user's CAD program. We have continued to develop enhancements to the 3XX to improve performance, serviceability and reliability. In 1997, we introduced two new reticle and photomask inspection enhancements, the Advanced Performance Algorithm and the STARlight(TM) high resolution option. These enhancements enable highly accurate and reliable inspection of next-generation sub-0.25-micron reticles, including reticles with complex optical proximity correction geometries. In July of 1999, we introduced the 365UV-HR, a new high numerical aperture ("NA") reticle pattern inspection tool for deep ultraviolet ("DUV"), sub-wavelength lithography. The industry's most sensitive UV reticle inspection tool available today, the 365UV-HR provides the advanced reticle inspection capabilities necessary for both high-volume manufacturing of 0.18-micron devices and early development of 0.13-micron processes. We are currently in a joint-development program with SEMATECH to develop the family of next-generation reticle inspection products designed for the needs of 0.13-micron production and 0.10-micron development. We expect these products to be introduced in the fall of 2000.

#### Film Measurement

Our film measurement products measure a variety of optical and electrical properties of thin films. These products are used to control a wide range of wafer fabrication steps, where within-wafer and wafer-to-wafer uniformity of the process is of paramount importance to semiconductor

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manufacturers - enabling them to achieve high device performance characteristics at the lowest possible cost.

In 1995, we introduced the UV-1250SE, which brought a powerful new technology to production, called spectroscopic ellipsometry. Next came the ASET-F5, our third generation spectroscopic ellipsometry tool, which addresses the difficult film measurement needs that come from the continuing evolution of film development driven by shorter linewidths. In 1999, we introduced an enhanced version of our award-winning ASET-F5 thin film measurement system, known as the ASET-F5x. It incorporates a single wavelength ellipsometry ("SWE") option to complement the industry-leading spectroscopic ellipsometry ("SE") and dual-beam spectrophotometry ("DBS") technologies incorporated in the ASET-F5. These combined capabilities provide the accuracy, repeatability and system-to-system matching required for the production of advanced ICs with geometries as small as 0.1 micron. In addition, the ASET-F5x is a bridge tool capable of handling either 200 mm or 300 mm wafers.

Our Quantox(R) product is a non-contact, electrical performance metrology system for gate dielectric films. Gate dielectric quality is critical to the speed and reliability of an IC. Quantox(R) measures key parameters such as contamination and oxide thickness used for gate dielectric process control to help maximize device yield.

#### Surface Metrology

Our Stylus profilers measure the surface topography of films and etched surfaces and are used in basic research and development as well as semiconductor production and quality control. We recently introduced the next generation of the award-winning HRP(R) high resolution profiler. This system combines the dishing and erosion measurement capabilities of our long-scan profilers with high aspect ratio etched feature measurement capability historically limited to atomic force microscopes. This allows customers to monitor their critical etch processes such as shallow trench isolation and dual-damascene via/trench. In addition, we produce stress measurement systems, which detect reliability-related problems such as film cracking, voiding and lifting.

#### CUSTOMER SERVICE AND SUPPORT

We enhance the value of our products through our Customer Service and Support services, which provide comprehensive worldwide service and support across all KLA-Tencor product lines. We also offer a yield management consulting service to improve our customers' return on investment.

Our customer support organization is responsible for much of the

support of our customers following the shipment of the equipment and software, including on-site repair, telephone support, system installation, relocation services, and selected post-sales applications. We also offer iSupport(TM), a fast, comprehensive and secure on-line customer support offering that enables KLA-Tencor's technical support and applications engineers to remotely access data from KLA-Tencor tools and operate them in real time to diagnose and rapidly resolve problems when they occur - all via a secure on-line connection controller by the customer at all times. Our Worldwide Support

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Operations Educational Services offers a comprehensive selection of technical courses from maintenance and service training to basic and advanced applications and operation. We offer standard and customized courses for individuals and groups both at the user's location and in one of our three training facilities. We also offer self-paced learning packages, including video, computer-based training and study plans.

In addition, we provide yield management consulting practice, which provides the systems, software and yield management expertise to speed the implementation of customers' yield improvement programs. This practice provides a broad range of services and support, including new fab yield management solution planning, factory and field customer applications training, dedicated ramp management support, integrated yield management consulting/applications support for effective solution implementation, and regional customer response centers with remote-access diagnostics. Use of our consulting practice provides accelerated yield learning rates and improved device performance for maximum return on investment.

#### CUSTOMERS

To support our growing, global customer base, we maintain a significant presence throughout the United States, Europe, Asia-Pacific and Japan, staffed with local sales and applications engineers, customer and field service engineers and yield management consultants. We count among our largest customers leading semiconductor manufacturers from each of these regions. In fiscal 2000, 1999 and 1998, no single customer accounted for more than 10% of our revenues.

Our business depends upon the capital expenditures of semiconductor manufacturers, which in turn depend on the current and anticipated market demand for integrated circuits and products utilizing integrated circuits. We do not consider our business to be seasonal in nature, but it is cyclical with respect to the capital equipment procurement practices of semiconductor manufacturers and is impacted by the investment patterns of such manufacturers in different global markets. Downturns in the semiconductor industry or slowdowns in the worldwide economy could have a material adverse effect on our future business and financial results.

#### SALES, SERVICE AND MARKETING

Our sales, service and marketing efforts are focused on building long-term relationships with our customers. We focus on providing a single and comprehensive resource for the full breadth of process control and yield management products and services. Customers benefit from the simplified planning and coordination, as well as the increased equipment compatibility found when dealing with a single supplier. Our revenues are derived primarily from product sales, principally through our direct sales force and - to a lesser extent - through distributors.

We believe that the size and location of our field sales, service and applications engineering, and marketing organizations represent a competitive advantage in our served markets. We have direct sales forces in the U.S., Europe, Asia-Pacific and Japan. We maintain an export compliance program that is designed to fully meet the requirements of the U.S. Departments of Commerce and State.

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Our facilities throughout the world employ over 2,200 sales personnel, service engineers and applications engineers. We maintain sales and service offices throughout the U.S. In addition, we have wholly-owned subsidiaries or branches of U.S. subsidiaries in Japan, Taiwan, Singapore, Malaysia, China, the United Kingdom, France, Germany, Switzerland, Italy and Israel for marketing, sales and service of our products. International sales accounted for approximately 70%, 60%, and 56% of our revenues in fiscal 2000, 1999, and 1998

respectively. Additional information regarding our revenues from foreign operations for our last three fiscal years is incorporated by reference from Note 8 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

We believe that sales outside the U.S. will continue to be a significant percentage of our revenues. Our future performance will depend, in part, on our ability to continue to compete successfully in Asia, one of the largest markets for the sale of yield management services in process monitoring equipment. Our ability to compete in this area is dependent upon the continuation of favorable trading relationships between countries in the region (especially Japan, Taiwan and Korea) and the United States, and our continuing ability to maintain satisfactory relationships with leading semiconductor companies in the region.

International sales and operations may be adversely affected by imposition of governmental controls, restrictions on export technology, political instability, trade restrictions, changes in tariffs and the difficulties associated with staffing and managing international operations. In addition, international sales may be adversely affected by the economic conditions in each country. The revenues from our international business may also be affected by fluctuations in currency exchange rates. Although we attempt to manage near term currency risks through "hedging," there can be no assurance that such efforts will be adequate. These factors could have a material adverse effect on our future business and financial results.

#### BACKLOG

Our backlog for systems totaled \$982 million at June 30, 2000, compared to \$449 million at June 30, 1999. We expect to fill the present backlog of orders during fiscal 2001; however, all orders are subject to cancellation or delay by the customer with limited or no penalty. Due to possible customer changes in delivery schedules and to cancellation of orders, our backlog at any particular date is not necessarily indicative of actual sales for any succeeding period.

#### RESEARCH AND DEVELOPMENT

The market for yield management and process monitoring systems is characterized by rapid technological development and product innovation. These technical innovations are inherently complex and require long development cycles and appropriate professional staffing. We believe continued and timely development of new products and enhancements to existing products are necessary to maintain our competitive position. Accordingly, we devote a significant portion of our human and financial resources to research and development programs and seek to maintain close relationships with customers to remain responsive to their needs. As part of our customer

relationships, we may enter into certain strategic development and engineering programs whereby our customers offset certain of our research and development costs.

Key activities during fiscal year 2000 involved development of process control and yield management equipment for smaller feature sizes, copper-based devices and 300mm wafers. For information regarding our research and development expenses during the last three fiscal years, including costs offset by our strategic development and engineering programs, see Item 7 "Management's Discussion and Analysis of Results of Operations and Financial Condition" in this Annual Report on Form 10-K.

In order to meet continuing developments in the semiconductor industry, we are committed to significant engineering efforts toward both product improvement and new product development. New product introductions may contribute to fluctuations in operating results, since customers may defer ordering existing products. If new products have reliability or quality problems, those problems may result in reduced orders, higher manufacturing costs, delays in acceptance of and payment for new products and additional service and warranty expenses. On occasion, we have experienced reliability and quality problems in connection with certain product introductions, resulting in some of these consequences. There can be no assurance that we will successfully develop and manufacture new hardware and software products, or that new hardware and software products introduced by us will be accepted in the marketplace. If we do not successfully introduce new products, our results of operations will be affected adversely.

## MANUFACTURING, RAW MATERIALS AND SUPPLIES

We perform system design, assembly and testing in-house and utilize an outsourcing strategy for the manufacture of components and major subassemblies. Our in-house manufacturing activities consist primarily of assembling and testing components and subassemblies that are acquired through third-party vendors and integrating those subassemblies into our finished products. Our principal manufacturing activities take place in San Jose and Milpitas, California, with additional operations in Bedford, Massachusetts and Migdal Ha'Emek, Israel. We employ approximately 1,350 manufacturing and 1,350 engineering personnel.

Many of the parts, components and subassemblies (collectively "parts") are standard commercial products, although certain items are made to KLA-Tencor specifications. We use numerous vendors to supply parts for the manufacture and support of our products. Although we make reasonable efforts to ensure that these parts are available from multiple suppliers, this is not always possible; and certain parts included in our systems may be obtained only from a single supplier or a limited group of suppliers. We endeavor to minimize the risk of production interruption by selecting and qualifying alternative suppliers for key parts, by monitoring the financial condition of key suppliers and by ensuring adequate inventories of key parts are available to maintain manufacturing schedules.

Although we seek to reduce our dependence on sole and limited source suppliers, in some cases the partial or complete loss of certain of these sources could disrupt scheduled deliveries to

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customers and have a material adverse effect on our results of operations and damage customer relationships.

## COMPETITION

The worldwide market for process control and yield management systems is highly competitive. In each of our product markets, we face competition from established and potential competitors, some of which may have greater financial, research, engineering, manufacturing and marketing resources than us, such as Applied Materials, Inc. and Hitachi Electronics Engineering Co., Ltd. We may also face future competition from new market entrants from other overseas and domestic sources. We expect our competitors to continue to improve the design and performance of their current products and processes and to introduce new products and processes with improved price and performance characteristics. We believe that to remain competitive, we will require significant financial resources to offer a broad range of products, to maintain customer service and support centers worldwide and to invest in product and process research and development.

Significant competitive factors in the market for process control and yield management systems include system performance, ease of use, reliability, installed base and technical service and support. We believe that, while price and delivery are important competitive factors, the customers' overriding requirement is for systems which easily and effectively incorporate automated and highly accurate inspection and metrology capabilities into their existing manufacturing processes, thereby enhancing productivity.

Our process control and yield management systems for the semiconductor industry are intended to compete based upon performance and technical capabilities. These systems may compete with less expensive and more labor-intensive manual inspection devices.

Management believes that KLA-Tencor is a strong competitor with respect to both its products and services. However, any loss of competitive position could negatively impact our prices, customer orders, revenues, gross margins, and market share, any of which would negatively impact our operating results and financial condition.

## ACQUISITIONS

We continue to pursue a course of strategic acquisitions and alliances to expand our technologies, product offerings and distribution capabilities. In fiscal 2000, we acquired two companies and a division of a third company to further our position in key markets and technologies:

We acquired ACME Systems, Inc., a leading supplier of yield engineering analysis software used to correlate electrical test and wafer sort yield data with in-line Work In Process and Metrology Data.

We acquired FINLE Technologies, Inc., which supplies lithography modeling and data analysis software which enables semiconductor manufacturers to speed development of advanced lithography processes required to develop and produce integrated circuits with 0.13 micron and smaller geometrics.

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We acquired Fab Solutions, a division of ObjectSpace, Inc., which provides advanced process control software solutions for semiconductor manufacturing, enabling yield and process engineers to respond to the major yield-impacting parametric data in a fab in near-real time.

The financial position and results of operations of all three acquisitions were immaterial in relation to those of KLA-Tencor and each transaction was accounted for as a purchase. Further details of these acquisitions are incorporated by reference from Note 3 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

Acquisitions involve numerous risks, including management issues and costs in connection with integration of the operations, technologies, and products of the acquired companies, possible write-downs of impaired assets, and the potential loss of key employees of the acquired companies. The inability to manage these risks effectively could negatively impact our operating results and financial condition.

#### PATENTS AND OTHER PROPRIETARY RIGHTS

We protect our proprietary technology through reliance on a variety of intellectual property laws, including patent, copyright and trade secrets. We have filed and obtained a number of patents in the United States and abroad and intend to continue to pursue the legal protection of our technology through intellectual property laws. In addition, from time to time we acquire license rights under U.S. and foreign patents and other proprietary rights of third parties.

Due to the rapid pace of innovation within the process control and yield management systems industry, management believes that our protection of patent and other intellectual property rights is less important than factors such as our technological expertise, continuing development of new systems, market penetration, installed base and the ability to provide comprehensive support and service to customers.

No assurance can be given that patents will be issued on any of our applications, that license assignments will be made as anticipated or that our patents, licenses or other proprietary rights will be sufficiently broad to protect our technology. No assurance can be given that any patents issued to or licensed by us will not be challenged, invalidated or circumvented or that the rights granted thereunder will provide us with a competitive advantage. In addition, there can be no assurance that we will be able to protect our technology or that competitors will not be able to independently develop similar or functionally competitive technology.

#### EMPLOYEES

As of June 30, 2000, we employed a total of approximately 5,800 persons. None of our employees are represented by a labor union. We have experienced no work stoppages and believe that our employee relations are good.

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Competition is intense in the recruiting of personnel in the semiconductor and semiconductor equipment industry. We believe that our future success will depend in part on our continued ability to hire and retain qualified management, marketing and technical employees.

#### ITEM 2. PROPERTIES

KLA-Tencor operates in a number of locations worldwide. In fiscal 2000,

we had one significant real estate transaction:

During the fourth quarter of fiscal 2000, we announced an agreement to purchase up to 43 acres of land in Livermore, California, to build a new campus. The campus will initially include two new 120,000-square-foot buildings dedicated to manufacturing and customer service with a plan to build four additional buildings on the campus over the next five years. Construction on the new campus is scheduled to begin during the first quarter of fiscal 2001. Further details of this new campus are incorporated by reference from Note 7 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

Information regarding our principal properties at June 30, 2000 is set forth below:

LOCATION	TYPE	PRINCIPAL USE	FOOTAGE	OWNERSHIP
Phoenix, AZ	Office	Sales and Service	9,736	Leased
Livermore, CA	Office	Sales and Service	19,604	Leased
Milpitas, CA	Office, plant and warehouse	Research and Engineering, Marketing, Manufacturing, Sales and Service and Sales Administration	18,463 728,902	Leased Owned
San Jose, CA	Office, plant and warehouse	Corporate Headquarters, Research and Engineering, Marketing, Manufacturing, Sales and Service and Sales Administration	224,143 518,736	Leased Owned
Scotts Valley, CA	Office, plant	Research and Development	9,945	Leased
Bedford, MA	Office, plant	Administration, Manufacturing, Sales and Service	50,000	Owned
Portsmouth, NH	Office	Sales and Service	6,000	Leased
Beaverton, OR	Office	Sales and Service	7,567	Leased
Austin, TX	Office	Sales and Service, Training	66,069	Leased
Richardson, TX	Office	Sales and Service, Training	22,507	Leased
Basingstoke and Wokingham, England	Office, plant	Sales and Service, Warehouse	16,475	Leased

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Dresden and Puchheim, Germany	Office	Sales and Service	14,975	Leased
Grenoble, and Evry, France	Office	Sales and Service	8,834	Leased
Yokohama, Japan	Office	Sales and Service	71,794	Leased
Singapore	Office	Sales and Service	6,168	Leased
Hsinchu, Taiwan	Office	Sales and Service	14,892	Leased
Migdal Ha'Emek and Herzliya, Israel	Office	Research and Engineering, Marketing, Manufacturing and Sales and Service and Sales Administration	53,800	Leased

We also lease office space for other, smaller sales and service offices in several locations throughout the world. Our operating leases expire at various times through June 30, 2012 with renewal options at the fair market value for additional periods up to five years. Detail of these leases is incorporated by reference from Note 7 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K.

### ITEM 3. LEGAL PROCEEDINGS

We are named from time to time as a party to lawsuits in the normal course of our business. Litigation, in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. We believe that we have defenses in each of the cases set

forth below and are vigorously contesting each of these matters.

Therma-Wave, Inc.

Therma-Wave I: On September 3, 1998, we initiated a patent infringement suit against Therma-Wave, Inc. alleging that certain products manufactured by Therma-Wave infringe a patent relating to film thickness measuring technology. On January 14, 1999, Therma-Wave filed a counterclaim against KLA-Tencor for patent infringement with respect to one of its thin film technology patents. We believe that the allegations contained in the counterclaim are unfounded and intend to vigorously defend our position, and we have meritorious defenses to those counterclaims. We believe that even if the outcome of the litigation is adverse to us it will not have a material adverse effect on our business, financial condition or results of operations.

Therma-Wave II: On July 22, 1999, we filed a second action against Therma-Wave in which we alleged that Therma-Wave infringes another patent relating to thin film thickness measuring technology. We are seeking damages and an injunction to stop the sale of the equipment that employs the infringing technology. On October 25, 1999, Therma-Wave filed a counterclaim against KLA-Tencor for patent infringement with respect to two patents relating to optical measurement systems. The counterclaim also includes allegations that KLA-Tencor engaged in a pattern of conduct designed to disparage and improperly damage Therma-Wave. We believe that the allegations contained in the counterclaim are unfounded, we intend to vigorously defend our position, and we have meritorious defenses to those counterclaims. We believe that the outcome

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from such litigation, even if adverse to us, would not have a material adverse effect on our business, financial condition or results of operations.

Schlumberger, Inc. and Rigg Systems

On August 30, 1999, we were named as a defendant in a lawsuit in which Schlumberger, Inc. alleges trade secret misappropriation, unfair competition and trade slander. On July 21, 2000, the court granted our motion for summary judgment dismissing the case. Schlumberger, Inc. subsequently filed a motion for reconsideration of that dismissal and we are awaiting a ruling on that motion. Although the outcome of these claims cannot be predicted with certainty, we do not believe that this legal matter will have a material adverse effect on our financial condition even if plaintiff prevails. On January 26, 2000, we filed a complaint against Philip Rigg, RIGG Systems and Schlumberger, Inc. for misappropriation of trade secrets, breach of contract, breach of fiduciary duty, interference with contract, and unfair competition. The defendants filed cross-complaints on June 5, 2000 asserting various statutory and common law theories. Although the outcome of these claims cannot be predicted with certainty, we do not believe that this legal matter will have a material adverse effect on our financial condition or results of operations even if the plaintiff prevails.

#### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None.

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## PART II

#### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON STOCK AND RELATED STOCKHOLDER MATTERS

KLA-Tencor's common stock is traded on the NASDAQ Stock Market and is quoted on the NASDAQ National Market under the symbol KLAC. The price per share reflected in the following table represents the range of high and low closing prices for our common stock on the NASDAQ National Market for the periods indicated.

1999

High

Low

First Quarter	\$ 16 5/32	\$ 10 5/8
Second Quarter	22 7/8	10 3/4
Third Quarter	30 15/16	22 7/8
Fourth Quarter	32 7/16	21 27/32

2000	High	Low
First Quarter	\$ 36 11/16	\$ 31 11/32
Second Quarter	55 11/16	33 1/8
Third Quarter	91 1/8	49 11/32
Fourth Quarter	97 7/16	44 1/8

The stock prices shown above have been restated to reflect KLA-Tencor's two-for-one stock dividend, effective January 18, 2000.

As of September 1, 2000, there were 1,434 shareholders of record of the Company's common stock. The closing price for the Company's common stock as reported by the NASDAQ National Market as of the close of business on September 1, 2000 was \$66 13/16 per share.

The Company has never paid cash dividends to its stockholders and does not presently plan to pay cash dividends in the foreseeable future.

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#### ITEM 6. SELECTED FINANCIAL DATA

The following tables reflect selected consolidated summary financial data for each of the last five fiscal years. This data should be read in conjunction with the consolidated financial statements and notes thereto, and with Item 7, "Management's Discussion and Analysis of Results of Operations and Financial Condition" in this Annual Report on Form 10-K.

Year ended June 30, (in thousands, except per share data)	1996	1997	1998	1999	2000
-----					
CONSOLIDATED STATEMENT OF OPERATIONS:					
Revenues	\$ 1,094,492	\$ 1,031,824	\$ 1,166,325	\$ 843,181	\$ 1,498,812
Income (loss) from operations	296,266	145,832	164,631	(10,334)	311,541
Income from operations excluding other charges(1)	296,266	206,384	187,105	32,366	306,903
Net income	196,634	105,396	134,096	39,212	253,798
Basic earnings per share	1.21	0.65	0.79	0.23	1.39
Diluted earnings per share	1.17	0.62	0.76	0.22	1.32
Net income excluding other charges(1)	196,634	151,272	155,574	66,966	250,783
Diluted earnings per share excluding other charges(1)	1.17	0.89	0.88	0.37	1.30
June 30, (in thousands)	1996	1997	1998	1999	2000
-----					
CONSOLIDATED BALANCE SHEETS:					
Cash, cash equivalents and marketable securities	\$ 468,475	\$ 687,249	\$ 723,481	\$ 755,183	\$ 964,383
Working capital	591,397	531,313	605,688	590,024	1,056,927
Total assets	1,157,919	1,343,307	1,548,397	1,584,900	2,203,503
Stockholders' equity	870,999	1,014,613	1,197,714	1,232,583	1,708,676

(1) Excludes non-recurring acquisition, merger and restructuring charges/(credits) of \$61 million, \$22 million, \$43 million and \$(5) million in 1997, 1998, 1999 and 2000 respectively.

The per share data shown above have been restated to reflect KLA-Tencor's two-for-one stock dividend, effective January 18, 2000.

#### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

The following discussion of our financial condition and results of operations should be read in conjunction with our consolidated financial statements and the related notes included in Item 8, "Financial Statements and



Supplementary Data" in this Annual Report on Form 10-K. This discussion contains forward-looking statements which involve risk and uncertainties. Our actual

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results could differ materially from those anticipated in the forward looking statements as a result of certain factors, including but not limited to those discussed in "Risk Factors" and elsewhere in this report.

#### RESULTS OF OPERATIONS

We enjoyed a strong fiscal 2000, with record bookings and revenues in both the third and fourth quarters of the year. The upturn in the semiconductor industry, which began in the latter half of fiscal 1999, continued throughout fiscal 2000. With the increasing affordability of personal computers and the growing demand to get online, computer hardware manufacturers, including personal computers and servers, continued their growth in both shipments and revenues. In addition, the telecommunications industry saw an increase in demand for its products, including software-enhanced wireless communications and internet-access products. This increased demand was further enhanced by a strong economic recovery in the Asia-Pacific region. This overall increase in demand caused price increases in the semiconductor industry and resulted in semiconductor manufacturers increasing capital spending not only to expand capacity in foundries to meet the increased demand for computer products, but also to implement processes that incorporate the latest in technological advances, including the adoption of deep sub-quarter micron technologies (0.13), the transition to copper dual damascene structures (copper technology) and the transition to 300mm wafers.

We experienced increased order levels across almost all products as a result of the increased capital spending by major semiconductor manufacturers, with our wafer inspection area benefiting the most. Geographically, all regions saw increases in bookings during the year, with the most pronounced improvements in the United States, Korea, Japan and Taiwan.

Our financial position has remained strong throughout fiscal 2000 and we continue to have no long-term debt. We have continued our new product development by investment in leading edge technologies and by strategic acquisitions. These investments should position our extensive product line to address the critical initiatives that are key to our customers.

#### REVENUES AND GROSS MARGIN

In fiscal 2000, revenues increased \$656 million, or 78% to \$1.50 billion, from \$843 million in fiscal 1999. Overall revenue increases were the result of increased capital spending by semiconductor manufacturers, particularly in the Asia-Pacific region, as a result of the semiconductor industry upturn. Sales of substantially all our products were positively affected by this up cycle when compared to sales in fiscal 1999. The United States, Korea, Japan and Taiwan exhibited the strongest revenue growth during the year. The United States and Europe represented a larger proportion of revenues compared to historical norms, while Japan revenues, which increased dramatically, were still below historical rates. Revenue increases in fiscal 2000 were augmented by an increase in field service and spare parts revenues, primarily due to our increasing installed base worldwide. Revenues in fiscal 1999 decreased \$323 million, or 28% to \$843 million, from \$1.17 billion in fiscal 1998, primarily due to the downturn in the semiconductor industry.

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Gross margins as a percentage of revenues were 55%, 47% and 52% in fiscal 2000, 1999 and 1998, respectively. The increase in fiscal 2000 compared to fiscal 1999 was due primarily to increased capacity utilization resulting from higher unit volume, as well as faster growth of higher-margin product revenue. The decrease in fiscal 1999 compared to fiscal 1998 was primarily due to lower sales volume of our higher margin products and increased infrastructure costs of our field service organization.

#### ENGINEERING, RESEARCH AND DEVELOPMENT

Net engineering, research and development expenses were \$246 million, \$165 million, and \$182 million, or 16%, 20% and 16% of revenues in fiscal 2000, 1999, and 1998, respectively. The dollar increase in fiscal 2000 compared to fiscal 1999 was primarily attributable to increases in costs associated with our

ongoing efforts to develop products which address new market segments; enhancements to existing products including next-generation 300mm products; and inspection enhancements for sub-quarter micron technology. The dollar decrease in fiscal 1999 compared to fiscal 1998 was primarily attributable to development programs that were terminated as part of the realignment and streamlining of our product lines.

Net engineering, research and development expenses were partially offset by \$16 million, \$14 million and \$11 million in external funding received under certain strategic development programs conducted with several of our customers in fiscal 2000, 1999 and 1998, respectively.

Our future operating results will depend significantly on our ability to produce products and services that have a competitive advantage in our marketplace. To do this, we believe that we must continue to make substantial investments in our research and development efforts. We remain committed to product development in new and emerging technologies as we address the requirements of 0.18 micron and 0.13 micron feature sizes, real-time review, and the transition to copper technology. Our investments in new technology and existing product enhancements are intended to enable our customers to achieve higher productivity through cost-effective, leading edge technology solutions.

#### SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses were \$268 million, \$199 million and \$242 million, or 18%, 24% and 21% of revenues, in fiscal 2000, 1999, and 1998, respectively. The increase in dollars in fiscal 2000, as compared to fiscal 1999, was primarily due to increases in our selling and marketing infrastructure and commissions paid. The decrease in dollars in fiscal 1999, compared to fiscal 1998, was primarily attributable to our restructuring program, which included a consolidation of facilities, reductions in headcount and other cost saving measures, and to the overall downturn in the semiconductor industry.

#### NON-RECURRING ACQUISITION, RESTRUCTURING AND OTHER CHARGES

Non-recurring acquisition, restructuring and other charges/(credits) were \$(5) million, \$43 million and \$22 million in fiscal 2000, 1999, and 1998, respectively. These charges are directly

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attributable to non-recurring acquisition charges incurred as we continue to pursue a course of strategic acquisitions and alliances to expand our technologies, product offerings and distribution capabilities and to restructuring charges incurred in connection with our fiscal 1999 restructure plan.

Non-recurring acquisition charges for the year ended June 30, 2000

In March 2000, we purchased assets and related technology of Fab Solutions, a division of ObjectSpace, Inc. for an aggregate purchase price of \$8 million. Fab Solutions is a leading provider of advanced process control software solutions used to respond to yield-impacting parametric data in near-real time. We recorded a charge of \$0.8 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In February 2000, we acquired software developer FINLE Technologies, Inc., a supplier of lithography modeling and data analysis software used to speed development of advanced lithography processes required to develop and produce integrated circuits with 0.12 micron and smaller geometries, for an aggregate purchase price of \$5 million. We recorded a charge of \$0.5 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In November 1999, we acquired software developer ACME Systems, Inc., a leading supplier of yield engineering analysis software used to correlate parametric electrical test and wafer sort yield data with in-line Work In Process and Metrology data, for an aggregate purchase price of \$6.9 million. We recorded a charge of \$1.9 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

To determine the value of the in-process technology of the fiscal 2000 acquisitions, the expected future cash flow attributable to the in-process technology was discounted, taking into account the percentage of completion,

utilization of pre-existing technology, risks related to the characteristics and applications of the technology, existing and future markets, and technological risk associated with completing the development of the technology. The valuation approach used was a form of discounted cash flow approach commonly known as the "percentage of completion" approach whereby the cash flows from the technology are multiplied by the percentage of completion of the in-process technology. In each acquisition, the value of tangible net assets acquired was nominal.

Non-recurring acquisition charges for the year ended June 30, 1999

In December 1998, we purchased assets and related technology from Uniphase Corporation for an aggregate purchase price of \$3 million. The confocal laser review station technology acquired is currently used for analysis of defects on silicon wafers. Assets acquired of \$3 million consisted primarily of inventory.

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In November 1998, we purchased assets and technology from Keithley Instruments, Inc. for an aggregate purchase price of \$10 million. The corona wire gate oxide monitoring tool technology we acquired had not yet reached the alpha stage and the cost to complete the development of this equipment was estimated at the time of acquisition to be \$1 million. We recorded a charge of \$8 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In June 1998, we acquired Groff Associates, Inc. (dba VARS Inc.) for an aggregate purchase price of \$13 million. The digital and in-line-monitoring image archiving retrieval software technology we acquired had not yet reached the alpha stage and the cost to complete the development of these software products was estimated at the time of acquisition to be \$2 million. We recorded a charge of \$13 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In May 1998 we acquired DeviceWare, Inc., a company in its development stage, for an aggregate purchase price of \$3 million. The bit mapping defect characterization technology acquired had not yet reached the alpha stage and the cost to complete the development of this software product was estimated at the time of acquisition to be \$1 million. We recorded a charge of \$3 million for purchased in-process research and development, representing the appraised value of product that was not considered to have reached technological feasibility.

For each of the above three fiscal 1999 transactions, the appraised value under the income approach used for our calculation did not differ materially from the result under the percentage of completion approach preferred by the Securities and Exchange Commission. The value of the tangible net assets acquired was nominal.

Each of the above acquisitions was accounted for using the purchase method of accounting and the developmental products acquired were evaluated in the context of Interpretation 4 of SFAS No. 2 and SFAS No. 86. The allocation of the purchase price to in-process research and development cost was determined by identifying research projects in areas for which technological feasibility had not been established and no alternative future uses existed. Substantially all of the in-process research and development projects acquired were expected to be complete and generating revenues within the 24 months following the acquisition date.

Non-recurring acquisition charges for the year ended June 30, 1998

In February 1998, we acquired Nanopro GmbH (Freiburg, Germany) for an aggregate purchase price of \$3 million. This privately-held company specialized in the development of advanced interferometric wafer inspection. The identified in-process research and development of \$3 million was estimated and expensed, because technological feasibility of the advanced interferometric wafer technology had not yet been reached. The technology acquired had not reached commercial feasibility as of June 30, 1999. The value of the tangible net assets acquired was nominal.

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In April 1998, we acquired Amray, Inc. (Amray) for 1,800,000 shares of

our common stock accounted for under the pooling of interest method of accounting. A privately-owned provider of scanning electron microscope systems, Amray's historical operations, net assets, and cash flows were less than 3% of our consolidated financial results and, therefore, were not reflected in the consolidated financial results prior to the acquisition.

Development of acquired technologies remains a significant risk due to the remaining effort required to achieve technical feasibility, rapidly changing customer markets and significant competitive threats from numerous companies. Failure to bring any of these products to market in a timely manner could adversely affect our sales and profitability in the future. Additionally, the value of net assets and other intangible assets acquired may become impaired.

#### Restructuring and Other Charges

During fiscal 1999, we implemented a restructuring plan to address the impact on our business of the downturn in the semiconductor industry. Estimated restructuring costs of \$35 million were classified in four main categories: facilities, inventory, severance and benefits, and other restructuring costs. Facilities costs of \$12 million include \$8 million for lease expense resulting from consolidation and closure of certain offices located primarily in the United States and Japan; \$3 million for leasehold improvements impaired in those facilities; and \$1 million in other facilities-related exit costs. Inventory-related costs of \$10 million resulted from impaired assets related to unique parts and non-cancelable purchase commitments of certain development programs, which were terminated as part of the realignment and streamlining of our product lines. Severance and benefit-related costs of \$8 million include involuntary termination of approximately 250 personnel from manufacturing, engineering, sales, marketing, and administration throughout the United States, Japan and Europe. Other restructuring costs of \$5 million relate primarily to the write-off of software licenses and related non-cancelable maintenance contracts for closed locations.

During fiscal 2000 and 1999, we utilized \$7 million and \$18 million of the restructuring accrual, respectively. During fiscal 2000, we determined that \$8 million of the reserve would not be utilized because of a change in management's plans for utilization of certain facilities resulting from an increase in demand for the Company's products. At June 30, 2000, \$2 million of the accrual remains, representing payments under severance plans and contractual obligations that existed when the plan was executed. These charges are expected to be incurred during the next six fiscal quarters.

#### INTEREST INCOME AND OTHER, NET

Interest income and other, net was \$42 million, \$61 million and \$42 million in fiscal 2000, 1999, and 1998, respectively. Interest income and other, net is comprised primarily of gains realized on sales of marketable securities, interest income earned on the investment and cash portfolio and income recognized upon settlement of certain foreign currency contracts. The decrease in fiscal 2000 as compared to fiscal 1999 and the increase in fiscal 1999 as compared to fiscal 1998 are primarily due to \$17 million in gains realized on the sale of equity securities held in a former supplier company in fiscal 1999.

#### PROVISION FOR INCOME TAXES

KLA-Tencor's effective income tax rate was 28%, 22% and 35% in fiscal 2000, 1999 and 1998, respectively. In general, our effective income tax rate differs from the statutory rate of 35% largely as a function of benefits realized from our Foreign Sales Corporations, income derived from tax exempt interest, foreign taxes, state taxes, and research and development tax credits. During fiscal 1999, income related to tax exempt interest increased as a component of total net income in addition to the impact of restructuring, which resulted in a significantly lower effective tax rate as compared to fiscal 1998 and 2000.

Our future effective income tax rate depends on various factors, such as tax legislation, the geographic composition of our pre-tax income, non-tax deductible expenses incurred in connection with acquisitions, amounts of tax-exempt interest income and research and development credits as a percentage of aggregate pre-tax income and the effectiveness of our tax planning strategies.

## LIQUIDITY AND CAPITAL RESOURCES

Working capital was \$1.06 billion as of June 30, 2000 compared to \$590 million as of June 30, 1999. Cash, cash equivalents and short-term investments increased to \$598 million from \$331 million at June 30, 1999. In addition, we maintained \$366 million and \$424 million in marketable securities classified as long-term as of June 30, 2000 and 1999, respectively.

Cash provided by operating activities was \$250 million, \$122 million, and \$74 million in fiscal 2000, 1999 and 1998, respectively. The increase in cash provided by operating activities in fiscal 2000 compared to fiscal 1999 was primarily due to the increase in net income and other current liabilities, offset by increased levels of accounts receivable, inventories and deferred taxes. The increase in cash provided by operating activities in fiscal 1999 compared to fiscal 1998 was primarily due to decreased levels of accounts receivable and inventory and increases in depreciation and amortization, partially offset by decreases in net income, accounts payable, other current liabilities and increases in other assets.

Cash used in investing activities was \$96 million, \$38 million and \$173 million in fiscal 2000, 1999 and 1998, respectively. Investing activities typically consist of purchases and sales of investments, purchases of capital assets to support long-term growth and acquisitions of technology or other companies to allow access to new market segments or emerging technologies. During fiscal 2000, we invested \$79 million in the acquisition of capital assets, with the majority of these expenditures related to leasehold improvements and to the purchase of computers and manufacturing equipment. Capital expenditures of \$61 million in fiscal 1999 included \$27 million to acquire land and buildings that previously were leased. The remaining \$34 million in fiscal 1999 and the \$64 million in fiscal 1998 related primarily to purchase of computers and manufacturing equipment.

We generated \$61 million of cash from financing activities in fiscal 2000, used \$16 million in fiscal 1999 and generated \$16 million in fiscal 1998. Financing activities typically include sales and repurchases of KLA-Tencor's common stock, as well as borrowings and repayments of debt.

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Issuance of common stock, net of repurchases, provided \$79 million in fiscal 2000, used \$7 million in fiscal 1999 and provided \$18 million in fiscal 1998.

During fiscal 2000 and 1999, we sold, with recourse, trade notes and accounts receivable from Japanese customers. At June 30, 2000 and 1999, \$52 million and \$29 million, respectively, of these receivables were outstanding.

During fiscal 1998, we entered into certain lease arrangements in Milpitas and San Jose, California. In connection with these agreements, we have a contingent liability to the lessor for \$100 million in residual value guarantees of the properties under lease. The impact of these agreements is not expected to be material to our liquidity.

We believe that the existing cash balances and investments, along with cash generated from operations, will be sufficient to meet our working capital requirements through fiscal year 2001.

We have adopted a plan for the systematic repurchase of shares of our common stock in the open market to reduce the dilution created by our stock-based employee benefit and incentive plans. In fiscal 2000, we repurchased 520,000 shares of our common stock at an average price of \$53.80 per share, for a total cash outlay of \$28 million. In fiscal 1999, we repurchased 2,152,000 shares of our common stock at an average price of \$22.66 per share, for a total cash outlay of \$49 million.

At June 30, 2000, our principle sources of liquidity consisted of \$964 million of cash, cash equivalents, and investments, and approximately \$30 million of available credit facilities. We have \$30 million of revolving lines of credit which renew annually. No amounts were outstanding under these agreements at the end of any fiscal year presented.

Our liquidity is affected by many factors, some of which are based on the normal ongoing operations of the business, and others of which relate to the uncertainties of global economies and the semiconductor and the semiconductor equipment industries. Although cash requirements will fluctuate based on the timing and extent of these factors, KLA-Tencor management believes that cash generated from operations, together with the liquidity provided by existing cash balances and borrowing capability, will be sufficient to satisfy our liquidity

requirements for the next 12 months.

#### FACTORS AFFECTING RESULTS, INCLUDING RISKS AND UNCERTAINTIES

##### Fluctuations in Operating Results and Stock Price

Our operating results have varied widely in the past and our future operating results will continue to be subject to quarterly variations based upon a wide variety of factors including those listed in this section and throughout this Annual Report on Form 10-K. In addition, future operating results may not follow any past trends. The factors we believe make our results more likely to fluctuate and difficult to predict include:

- the cyclical nature of the semiconductor industry;
- the reduction in the price and the profitability of our products;
- our timing of new product introductions;

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- our ability to develop and implement new technologies;
- the change in customers' schedules for fulfillment of orders;
- the cancellation of contracts by major customers;
- the shortage of qualified workers in the areas we operate; and
- our ability to manage our manufacturing requirements.

Operating results also could be affected by sudden changes in customer requirements, currency exchange rate fluctuations and other economic conditions affecting customer demand and the cost of operations in one or more of the global markets in which we do business. As a result of these or other factors, we could fail to achieve our expectations as to future revenues, gross profit and income from operations. Our failure to meet the performance expectations set and published by external sources could result in a sudden and significant drop in the price of our stock, particularly on a short-term basis, and could negatively affect the value of any investment in our stock.

##### Semiconductor Equipment Industry Volatility

The semiconductor equipment industry is highly cyclical. The purchasing decisions of our customers are highly dependent on the economies of both the local markets in which they are located and the semiconductor industry worldwide. The timing, length and severity of the up-and-down cycles in the semiconductor equipment industry are difficult to predict. This cyclical nature of the industry in which we operate affects our ability to accurately predict future revenues and, thus, future expense levels. When cyclical fluctuations result in lower than expected revenue levels, operating results may be adversely affected and cost reduction measures may be necessary in order for us to remain competitive and financially sound. During a down cycle we must be in a position to adjust our cost and expense structure to the prevailing market condition and to continue to motivate and retain our key employees. In addition, during periods of rapid growth, we must be able to increase manufacturing capacity and personnel to meet customer demand. We can provide no assurance that these objectives can be met in a timely manner in response to industry cycles. If we fail to respond to industry cycles, our business could be seriously harmed.

During the most recent down cycle, the semiconductor industry experienced excess production capacity that caused semiconductor manufacturers to decrease capital spending. We generally do not have long-term volume production contracts with our customers and we do not control the timing or volume of orders placed by our customers. Whether and to what extent our customers place orders for any specific products and the mix and quantities of products included in those orders are factors beyond our control. Insufficient orders, especially in our down cycles, will result in under-utilization of our manufacturing facilities and infrastructure and will negatively affect our operating results and financial condition.

##### International Trade and Economic Conditions

Ours is an increasingly global market. A majority of our revenues are derived from outside the United States and we expect that international revenues will continue to represent a substantial percentage of our revenues. Our international revenues and operations are affected by economic conditions specific to each country and region. Although economies in the Asia Pacific region have

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stabilized to some degree, compared to early-to-mid fiscal 1999, and certain countries such as Taiwan have relatively healthy economies, we remain cautious about general macroeconomic developments in the Asia Pacific region, particularly Japan. Japan's economy is important to the overall financial health of the region. If the economies in the Asia Pacific region stagnate or deteriorate, the economies of other regions could also be affected. Because of our significant dependence on international revenues, a continued or additional decline in the economies of any of the countries or regions in which we do business would negatively affect our operating results.

Managing global operations and sites located throughout the world presents challenges associated with, among other things, cultural diversity and organizational alignment. Moreover, each region in the global semiconductor equipment market exhibits unique characteristics that can cause capital equipment investment patterns to vary significantly from period to period. Periodic local or international economic downturns, trade balance issues, political instability and fluctuations in interest and currency exchange rates could negatively affect our business and results of operations. Although we attempt to manage near term currency risks through the use of hedging instruments, there can be no assurance that such efforts will be adequate.

#### Competition

Our industry includes large manufacturers with substantial resources to support customers worldwide. Our future performance depends, in part, upon our ability to continue to compete successfully worldwide. Some of our competitors are diversified companies with greater financial resources and more extensive research, engineering, manufacturing, marketing and customer service and support capabilities than we can provide. We face competition from companies whose strategy is to provide a broad array of products and services, some of which compete with the products and services that we offer. These competitors may bundle their products in a manner that may discourage customers from purchasing our products. In addition, we face competition from smaller emerging semiconductor equipment companies whose strategy is to provide a portion of the products and services which we offer, using innovative technology to sell products into specialized markets. Loss of competitive position could negatively impact our prices, customer orders, revenues, gross margins, and market share, any of which would negatively affect our operating results and financial condition. Our failure to compete successfully with these other companies would seriously harm our business.

#### Technological Change and Customer Requirements

Success in the semiconductor equipment industry depends, in part, on continual improvement of existing technologies and rapid innovation of new solutions. For example, the semiconductor industry continues to shrink the size of semiconductor devices and has begun to commercialize the process of copper-based interconnects. These and other evolving customer needs require us to respond with continued development programs and to cut back or discontinue older programs which may no longer have industry-wide support. Technical innovations are inherently complex and require long development cycles and appropriate professional staffing. Our competitive advantage and future business success depend on our ability to accurately predict evolving industry standards, develop and introduce new products which successfully address changing customer needs, win

market acceptance of these new products and manufacture these new products in a timely and cost-effective manner. If we do not develop and introduce new products and technologies in a timely manner in response to changing market conditions or customer requirements, our business could be seriously harmed.

In this environment, we must continue to make significant investments in research and development in order to enhance the performance and functionality of our products, to keep pace with competitive products and to satisfy customer demands for improved performance, features and functionality. There can be no assurance that revenues from future products or product enhancements will be sufficient to recover the development costs associated with such products or enhancements or that we will be able to secure the financial resources necessary to fund future development. Substantial research and development costs typically are incurred before we confirm the technical feasibility and commercial viability of a product, and not all development activities result in commercially viable products. In addition, we cannot ensure

that these products or enhancements will receive market acceptance or that we will be able to sell these products at prices that are favorable to us. Our business will be seriously harmed if we are unable to sell our products at favorable prices or if our products are not accepted by the market in which we operate.

#### Key Suppliers

We use a wide range of materials in the production of our products including custom electronic and mechanical components, and we use numerous suppliers to supply materials. We generally do not have guaranteed supply arrangements with our suppliers. Because of the variability and uniqueness of customers' orders, we do not maintain an extensive inventory of materials for manufacturing. We seek to minimize the risk of production and service interruptions and/or shortages of key parts by selecting and qualifying alternative suppliers for key parts, monitoring the financial stability of key suppliers, and maintaining appropriate inventories of key parts. Although we make reasonable efforts to ensure that parts are available from multiple suppliers, key parts may be available only from a single supplier or a limited group of suppliers. There can be no assurance that our business will not be harmed if we do not receive sufficient parts to meet our production requirements in a timely and cost-effective manner.

Operations at our primary manufacturing facilities and our assembly subcontractors are subject to disruption for a variety of reasons, including work stoppages, fire, earthquake, flooding or other natural disasters. Such disruption could cause delays in shipments of products to our customers. We cannot ensure that alternate production capacity would be available if a major disruption were to occur, or that if it were available, it could be obtained on favorable terms. Such a disruption could result in cancellation of orders or loss of customers and could seriously harm our business.

#### Intellectual Property Obsolescence and Infringement

Our success is dependent in part on our technology and other proprietary rights. We own various United States and international patents and have additional pending patent applications relating to some of our products and technologies. The process of seeking patent protection is

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lengthy and expensive, and we cannot be certain that pending or future applications will actually result in issued patents, or that, issued patents will be of sufficient scope or strength to provide meaningful protection or commercial advantage to us. Other companies and individuals, including our larger competitors, may develop technologies that are similar or superior to our technology or design around the patents we own.

We also maintain trademarks on certain of our products and services and claim copyright protection for certain proprietary software and documentation. However, we can give no assurance that our trademarks and copyrights will be upheld or successfully deter infringement by third parties.

While patent, copyright and trademark protection for our intellectual property is important, we believe our future success in highly dynamic markets is most dependent upon the technical competence and creative skills of our personnel. We attempt to protect our trade secrets and other proprietary information through agreements with our customers, suppliers, employees and consultants and through other security measures. We also rely on trade secret protection for our technology, in part through confidentiality agreements with our employees, consultants and third parties. We also maintain exclusive and non-exclusive licenses with third parties for strategic technology used in certain products. However, these employees, consultants and third parties may breach these agreements, and we may not have adequate remedies for wrongdoing. In addition, the laws of certain territories in which we develop, manufacture or sell our products may not protect our intellectual property rights to the same extent as do the laws of the United States.

As is typical in the semiconductor equipment industry, from time to time we have received communications from other parties asserting the existence of patent rights, copyrights, trademark rights or other intellectual property rights which they believe cover certain of our products, processes, technologies or information. Our customary practice is to evaluate such assertions and consider whether to seek licenses where appropriate. Based on industry practice and prior experience, we believe that licenses or other rights, if necessary, will be available on commercially reasonable terms for existing or future claims. Nevertheless, we cannot ensure that licenses can be obtained, or if



obtained will be on acceptable terms or that litigation or other administrative proceedings will not occur. The inability to obtain necessary licenses or other rights on reasonable terms could seriously harm our operating results and financial condition.

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#### Key Employees

Our employees are vital to our success, and our key management, engineering and other employees are difficult to replace. We generally do not have employment contracts with our key employees. Further, we do not maintain key person life insurance on any of our employees. The expansion of high technology companies worldwide has increased demand and competition for qualified personnel. We may not be able to attract, assimilate or retain additional highly qualified employees in the future. These factors could seriously harm our business.

#### Acquisitions

We seek to develop new technologies from both internal and external sources. As part of this effort, we may make acquisitions of, or significant investments in, businesses with complementary products, services and/or technologies. Acquisitions involve numerous risks, including management issues and costs in connection with integration of the operations, technologies, and products of the acquired companies, possible write-downs of impaired assets, and the potential loss of key employees of the acquired companies. The inability to manage these risks effectively could seriously harm our business.

#### Litigation

From time to time we are involved in litigation which alleges infringement of intellectual property rights and other damages. This type of litigation tends to be expensive and requires significant management time and attention. In addition, if we lose in this type of litigation, a court could require us to pay substantial damages and/or royalties, prohibiting us from using essential technologies. For these and other reasons, this type of litigation could have a material adverse effect on our business, financial condition and results of operations. Also, although we may seek to obtain a license under a third party's intellectual property rights in order to bring an end to certain claims or actions asserted against us, we may not be able to obtain such a license on reasonable terms or at all.

#### Euro Conversion

A new European currency was implemented commencing in January 1999 to replace the separate currencies of eleven western European countries. This requires changes in our operations as we modify systems and commercial arrangements to deal with the new currency. Modifications are necessary in operations such as payroll, benefits and pension systems, contracts with suppliers and customers, and internal financial reporting systems. During the three-year transition period in which transactions may also be made in the old currencies, we must maintain dual currency processes for our operations. We have identified the issues created by this problem and the cost of this effort is not expected to have a material effect on our business or results of operations. We cannot be assured, however, that all problems will be foreseen and corrected or that no material disruption of our business will occur as a result of this currency change.

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#### EFFECTS OF RECENT ACCOUNTING PRONOUNCEMENTS

In June 1999, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 137 (SFAS No. 137), "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 amends Statement of Financial Accounting Standards No. 133 (SFAS No. 133), "Accounting for Derivative Instruments and Hedging Activities," to defer its effective date to all fiscal quarters of all fiscal years beginning after June 15, 2000. SFAS No. 133 establishes accounting and reporting standards for derivative instruments including standalone instruments, such as forward currency exchange contracts and interest rate swaps or embedded derivatives, such as conversion options contained in convertible debt investments and requires that these instruments be marked-to-market on an ongoing basis. Along with the derivatives, the underlying

hedged items are also to be marked-to-market on an ongoing basis. These market value adjustments are to be included either in the income statement or in stockholders' equity, depending on the nature of the transaction. The Company currently only participates in hedge transactions of assets, liabilities and firm commitments and does not anticipate that the adoption of this Statement will have a material impact on the financial statements as the gains and losses on the hedge transactions offset the losses and gains on the underlying items being hedged. The Company is required to adopt SFAS No. 133 in the first quarter of our fiscal year ending June 30, 2001. The effect of adopting SFAS No. 133 is not expected to be material to the Company's financial statements.

In March 2000, the FASB issued interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB 25." This Interpretation clarifies the FASB's views in applying Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" to certain stock compensation awards. FIN 44 is effective July 1, 2000, however certain conclusions in this Interpretation cover specific events that occur after December 15, 1998. To the extent this Interpretation covers events occurring during the period after December 15, 1998, but before the effective date of July 1, 2000, the effects of applying this Interpretation are recognized on a prospective basis from July 1, 2000. The implementation of FIN 44 is not expected to have any material impact on the Company's financial statements.

In June 2000, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101B (SAB 101B), "Second Amendment: Revenue Recognition in Financial Statements." SAB 101B amends Staff Accounting Bulletin No. 101 (SAB 101) "Revenue Recognition in Financial Statements," to defer the implementation date of SAB 101 for registrants until no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. SAB 101 summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements of all public companies. The Company is required to adopt SAB 101 in the fourth quarter of its fiscal year ending June 30, 2001. Accordingly, any shipments previously reported as revenue, including revenue reported for the first three quarters of fiscal 2001, that do not meet SAB 101's guidance will be recorded as revenue in future periods. Changes in our revenue recognition policy resulting from the interpretation of SAB 101 would not involve the restatement of prior fiscal year statements, but would, to the extent applicable, be reported as a change in accounting principle in the fiscal year ending June 30, 2001, with the

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appropriate restatement of interim periods as required by SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements." The Company's reported results of operations for the 12 months ending June 30, 2001 will include a cumulative adjustment for all prior annual and interim periods including an adjustment for revenue reported in the first quarter of fiscal 2001 as if SAB 101 had been adopted on July 1, 2000. The Company, in conjunction with the semiconductor capital equipment industry association is seeking clarification on the requirements of SAB 101 as they relate to the semiconductor capital equipment industry. Management believes that SAB 101 and 101B, to the extent that they impact us, will not affect the underlying strength or weakness of our business operations as measured by the dollar value of our product shipments and cash flows.

#### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We are exposed to financial market risks, including changes in interest rates, foreign currency exchange rates and marketable equity security prices. To mitigate these risks, we utilize derivative financial instruments. We do not use derivative financial instruments for speculative or trading purposes. All of the potential changes noted below are based on sensitivity analyses performed on our financial position at June 30, 2000. Actual results may differ materially.

At the end of fiscal 2000, we had an investment portfolio of fixed income securities of \$446 million, excluding those classified as cash and cash equivalents (Detail of these securities is incorporated by reference from Note 4 of Notes to Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K). These securities, as with all fixed income instruments, are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels as of June 30, 2000, the fair value of the portfolio would decline by \$5 million.

As of June 30, 2000 we had forward contracts to sell \$204 million in

foreign currency in order to hedge currency exposures (Detail of these contracts is incorporated by reference from Note 1 of the Notes to the Consolidated Financial Statements found under Item 8, "Financial Statements and Supplementary Data" in this Annual Report on Form 10-K). The fair market value of these contracts, based on prevailing exchange rates on June 30, 2000, was \$199 million. A 10% adverse move in currency exchange rates affecting the contracts would decrease the fair value of the contracts by \$20 million. However, if this occurred, the fair value of the underlying exposures hedged by the contracts would increase by a similar amount. Accordingly, we believe that the hedging of our foreign currency exposure should have no material impact to income or cash flows.

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ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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CONSOLIDATED BALANCE SHEETS

June 30, (in thousands, except per share data)	1999	2000
-----		
Assets		
Current assets:		
Cash and cash equivalents	\$ 271,488	\$ 478,212
Short-term investments	59,574	119,932
Accounts receivable, net	280,070	481,950
Inventories	195,679	282,489
Deferred income taxes	113,037	164,294
Other current assets	22,493	24,877
-----		
Total current assets	942,341	1,551,754
Land, property and equipment, net	168,335	199,719
Marketable securities	424,121	366,239
Other assets	50,103	85,791
-----		
Total assets	\$ 1,584,900	\$ 2,203,503
=====		
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable	\$ 14,567	\$ --
Accounts payable	35,249	55,016
Other current liabilities	302,501	439,811
-----		
Total current liabilities	352,317	494,827
-----		
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, \$0.001 par value, 1,000 shares authorized, none outstanding	--	--
Common stock, \$0.001 par value, 250,000 shares authorized, 177,364 and 187,465 shares issued and outstanding	177	187
Capital in excess of par value	504,175	717,978
Retained earnings	723,048	976,846
Accumulated other comprehensive income	5,183	13,665
-----		
Total stockholders' equity	1,232,583	1,708,676
-----		
Total liabilities and stockholders' equity	\$ 1,584,900	\$ 2,203,503
=====		

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF OPERATIONS

Year ended June 30, (in thousands, except per share data)	1998	1999	2000
Revenues	\$ 1,166,325	\$ 843,181	\$ 1,498,812
Costs and operating expenses:			
Cost of goods sold	554,917	447,059	677,805
Engineering, research and development	181,903	164,699	246,227
Selling, general and administrative	242,400	199,057	267,877
Non-recurring acquisition, restructuring and other charges	22,474	42,700	(4,638)
Total costs and operating expenses	1,001,694	853,515	1,187,271
Income (loss) from operations	164,631	(10,334)	311,541
Interest income and other, net	41,680	60,643	41,536
Income before income taxes	206,311	50,309	353,077
Provision for income taxes	72,215	11,097	99,279
Net income	\$ 134,096	\$ 39,212	\$ 253,798
Earnings per share:			
Basic	\$ 0.79	\$ 0.22	\$ 1.39
Diluted	\$ 0.76	\$ 0.21	\$ 1.32
Weighted average number of shares:			
Basic	170,194	175,474	182,177
Diluted	177,044	183,344	192,564

See accompanying notes to consolidated financial statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(in thousands)	Common Stock and Capital in Excess of Par Value		Retained Earnings	Accumulated Other Compre- hensive Income	Totals
	Shares	Amount			
Balances at June 30, 1997	167,518	\$ 458,308	\$ 542,706	\$ 13,599	\$ 1,014,613
Components of comprehensive income:					
Net income	--	--	134,096	--	134,096
Change in unrealized gain on investments	--	--	--	8,517	8,517
Currency translation adjustments	--	--	--	(5,821)	(5,821)
Total comprehensive income	--	--	--	--	136,792
Net issuance under employee stock plans	4,526	34,537	--	--	34,537
Repurchase of common stock	(756)	(16,038)	--	--	(16,038)
Tax benefits of stock option transactions	--	20,529	--	--	20,529
Issuance of Common stock in connection with acquisition	3,600	247	7,034	--	7,281
Balances at June 30, 1998	174,888	497,583	683,836	16,295	1,197,714
Components of comprehensive income:					
Net income	--	--	39,212	--	39,212
Change in unrealized gain on investments	--	--	--	(14,877)	(14,877)
Currency translation adjustments	--	--	--	3,765	3,765
Total comprehensive income	--	--	--	--	28,100
Net issuance under employee stock plans	4,628	41,324	--	--	41,324
Repurchase of common stock	(2,152)	(48,767)	--	--	(48,767)
Tax benefits of stock option transactions	--	14,212	--	--	14,212
Balances at June 30, 1999	177,364	504,352	723,048	5,183	1,232,583
Components of comprehensive income:					

Net income	--	--	253,798	--	253,798
Change in unrealized gain on investments	--	--	--	5,580	5,580
Currency translation adjustments	--	--	--	2,902	2,902
Total comprehensive income	--	--	--	--	262,280
Net issuance under employee stock plans	10,621	109,951	--	--	109,951
Repurchase of common stock	(520)	(27,978)	--	--	(27,978)
Tax benefits of stock option transactions	--	131,840	--	--	131,840
Balances at June 30, 2000	187,465	\$ 718,165	\$ 976,846	\$ 13,665	\$ 1,708,676

See accompanying notes to consolidated financial statements.

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#### CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended June 30, (in thousands)	1998	1999	2000
<b>Cash flows from operating activities:</b>			
Net income	\$ 134,096	\$ 39,212	\$ 253,798
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	38,917	48,217	63,338
Restructuring charges	--	35,000	(7,838)
In-process technology	20,546	7,700	3,200
Net (gain) loss on sale of marketable securities	--	(18,819)	5,306
Deferred income taxes	(46,225)	(27,930)	(60,522)
Changes in assets and liabilities:			
Accounts receivable	(57,542)	40,898	(185,262)
Inventories	(62,271)	30,834	(95,780)
Other assets	(16,951)	(15,449)	(13,549)
Accounts payable	3,821	(12,145)	18,969
Other current liabilities	59,769	(5,172)	270,857
Net cash provided by operating activities	74,160	122,346	252,517
<b>Cash flows from investing activities:</b>			
Purchase of technology and net assets	(18,771)	(10,047)	(19,925)
Purchase of property and equipment	(64,389)	(60,736)	(78,694)
Purchase of available for sale securities	(915,185)	(598,170)	(667,887)
Proceeds from sale of available for sale securities	825,643	631,188	670,052
Net cash used in investing activities	(172,702)	(37,765)	(96,454)
<b>Cash flows from financing activities:</b>			
Issuance of common stock, net	34,537	41,324	106,999
Stock repurchases	(16,038)	(48,767)	(27,978)
Net payments under short term debt obligations	(2,636)	(8,714)	(18,316)
Net cash provided by (used in) financing activities	15,863	(16,157)	60,705
Effect of exchange rate changes on cash and cash equivalents	19,424	(12,906)	(10,044)
Net increase (decrease) in cash and cash equivalents	(63,255)	55,518	206,724
Cash and cash equivalents at beginning of period	279,225	215,970	271,488
Cash and cash equivalents at end of period	\$ 215,970	\$ 271,488	\$ 478,212
<b>Supplemental cash flow disclosures:</b>			
Income taxes paid, net of refunds	\$ 85,394	\$ 10,437	\$ 1,243
Interest paid	\$ 2,303	\$ 2,073	\$ 1,131

See accompanying notes to consolidated financial statements.

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#### NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

##### NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

DESCRIPTION OF OPERATIONS AND PRINCIPLES OF CONSOLIDATION KLA-Tencor Corporation ("KLA-Tencor") is a global provider of process control and yield management solutions for the semiconductor manufacturing and related microelectronics industries. Headquartered in San Jose, California, KLA-Tencor has subsidiaries both in the United States and in key markets throughout the world.

The consolidated financial statements include the accounts of KLA-Tencor and our wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

**MANAGEMENT ESTIMATES** The preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

**FAIR VALUE OF FINANCIAL INSTRUMENTS** The Company has evaluated the estimated fair value of financial instruments using available market information and valuation methodologies. The amounts reported as investments and bank borrowings reasonably estimate their fair value. The fair value of the Company's cash, cash equivalents, accounts receivable, accounts payable and other current liabilities approximates the carrying amount due to the relatively short maturity of these items.

**CASH EQUIVALENTS** Cash equivalents consist of highly-liquid investments that are valued at amortized cost, which approximates market value, and have original maturity dates of three months or less from the date of acquisition.

**INVESTMENTS** Short-term investments include debt and equity securities acquired with maturities exceeding three months but less than one year from the date of acquisition. Marketable securities include debt and equity securities acquired with maturities exceeding one year from the date of acquisition. While KLA-Tencor's intent is to hold debt securities to maturity, consistent with Statement of Financial Accounting Standards (SFAS) No. 115, "Accounting for Certain Investments in Debt and Equity Securities," we have classified all debt securities and all investments in equity securities that have readily determinable fair values as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. Such securities are reported at fair value, with unrealized gains or losses excluded from earnings and included in "Accumulated other comprehensive income," net of applicable taxes, until realized. The cost of securities sold is based on the specific identification method. Realized gains or losses and declines in value, if any, judged to be other than temporary are reported in "Interest income and other, net" in the Consolidated Statements of Operations.

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**INVENTORIES** Inventories are stated at the lower of cost (on a first-in, first-out basis) or market. Demonstration units are stated at their manufacturing cost and reserves are recorded to state the demonstration units at their net realizable value.

**PROPERTY AND EQUIPMENT** Property and equipment are recorded at cost. Depreciation of property and equipment is based on the straight-line method over the estimated useful lives of the assets, which are 30 years for buildings, 10 years for building improvements, five to seven years for furniture and fixtures, and three to five years for machinery and equipment. Leasehold improvements are amortized by the straight-line method over the shorter of the life of the related asset or the term of the underlying lease.

**INTANGIBLE ASSETS** Purchased technology and goodwill are presented at cost, net of accumulated amortization, and are amortized over their estimated useful lives of three to five years using the straight-line method.

**SOFTWARE DEVELOPMENT COSTS** Development costs incurred in the research and development of new software products are expensed as incurred until technological feasibility of the product has been established. Software development costs incurred after technological feasibility has been established are capitalized up to the time the product is available for general release to customers. At June 30, 1999 and 2000, there were no amounts capitalized as KLA-Tencor's current development process is essentially complete concurrent with the establishment of technological feasibility.

**LONG-LIVED ASSETS** KLA-Tencor evaluates the carrying value of its long-lived assets, including identifiable intangible assets, whenever events or changes in circumstances indicate that the carrying value of the asset may be impaired. An impairment loss is recognized when estimated future cash flows expected to result from the use of the asset including disposition, is less than the carrying value of the asset. During fiscal 2000, no long-lived assets were determined to be impaired. During fiscal 1999, certain long-lived assets were determined to be impaired as part of the Company's restructuring plan (See Note

3).

CONCENTRATION OF CREDIT RISK Financial instruments, which potentially subject KLA-Tencor to credit risk, consist principally of investments, accounts receivable and derivative financial instruments used in hedging activities.

Investments are maintained with high-quality institutions, and the composition and maturities of investments are regularly monitored by management. Generally, these securities are traded in a highly liquid market, may be redeemed upon demand and bear minimal risk. The Company, by policy, limits the amount of credit exposure to any one financial institution or commercial issuer. The Company has not experienced any material losses on its investments.

A majority of the Company's trade receivables are derived from sales to large multinational semiconductor manufacturers throughout the world. Concentration of credit risk with respect to trade receivables is considered to be limited due to its customer base and the diversity of its geographic sales areas. The Company performs ongoing credit evaluations of its customers'

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financial condition. The Company maintains a provision for potential credit losses based upon expected collectibility of all accounts receivable.

The Company is exposed to credit loss in the event of nonperformance by counterparties on the foreign exchange contracts used in hedging activities. The Company does not anticipate nonperformance by these counterparties.

FOREIGN CURRENCY The functional currencies of the Company's significant foreign subsidiaries are the local currencies. Accordingly, all assets and liabilities of the foreign operations are translated to U.S. dollars at current period end exchange rates, and revenues and expenses are translated to U.S. dollars using average exchange rates in effect during the period. The gains and losses from foreign currency translation of these subsidiaries' financial statements are recorded directly into a separate component of stockholders' equity under the caption "Accumulated other comprehensive income." Currency transaction gains and losses have not been significant.

The Company's foreign subsidiaries operate and sell the Company's products in various global markets. As a result, the Company is exposed to changes in interest rates and foreign currency exchange rates. The Company utilizes foreign currency forward exchange contracts to hedge against certain future movements in foreign exchange rates that affect certain foreign currency denominated sales and purchase transactions. The Company attempts to match the forward contracts with the underlying items being hedged in terms of currency, amount, and maturity. The Company does not use derivative financial instruments for speculative or trading purposes. Since the impact of movements in currency exchange rates on forward contracts offsets most of the related impact on the exposures hedged, these financial instruments generally do not subject the Company to speculative risk that would otherwise result from changes in currency exchange rates. Realized gains and losses on forward exchange contracts are included in "Interest income and other, net," which offset foreign exchange gains or losses from revaluation of foreign currency-denominated receivable and payable balances. The cash flows related to gains and losses on these contracts are classified in the same category as the hedged transactions in the Consolidated Statements of Cash Flows.

At June 30, 2000, the Company had forward exchange contracts maturing throughout fiscal 2001 to sell and purchase \$289 million and \$85 million, respectively, in foreign currency, primarily Japanese yen. At June 30, 1999, the Company had forward exchange contracts maturing throughout fiscal 2000 and early fiscal 2001 to sell and purchase \$247 million and \$26 million, respectively, in foreign currency, primarily Japanese yen. Of the forward exchange contracts existing at June 30, 2000, \$181 million and \$80 million of contracts hedge foreign currency assets and liabilities, respectively, were carried on the consolidated balance sheet as of June 30, 2000, and consequently, the consolidated financial statements reflect the fair market value of the contracts and their underlying transactions. Contracts of \$108 million and \$5 million hedge firm commitments for future sales and purchases, respectively, denominated in foreign currency. The fair market value of these contracts on June 30, 2000, based upon prevailing market rates on that date, was \$106 million and \$5 million, respectively. As of June 30, 2000, and based on prevailing market rates on that date, the unrealized loss on outstanding contracts was \$2 million.

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REVENUE RECOGNITION KLA-Tencor generally recognizes systems and spares revenue when the product has been shipped, risk of loss has passed to the customer and collection of the resulting receivable is probable. A provision for the estimated costs of fulfilling warranty and installation obligations is recorded at the time the related revenue is recognized.

Service and maintenance revenue is recognized ratably over the term of the maintenance contract. If maintenance is included in an arrangement which includes a license agreement, amounts related to maintenance are allocated based on vendor specific objective evidence. In situations where maintenance is to be provided over a period beyond twelve months from the balance sheet date, the portion of revenue relating to those services is classified as noncurrent deferred revenue. Consulting and training revenue is recognized when the related services are performed.

Revenue from license fees is typically recognized upon shipment of the software if collection of the resulting receivable is probable, the fee is fixed or determinable, and vendor-specific objective evidence exists to allocate a portion of the total fee to any undelivered elements of the arrangement. Such undelivered elements in these arrangements typically consist of services. If vendor-specific objective evidence does not exist to allocate the total delivered and undelivered elements of the arrangement, revenue is deferred until such evidence does exist, or until all elements are delivered, whichever is earlier. In instances where an arrangement to deliver software requires significant modification or customization, license fees are recognized under the percentage of completion method of contract accounting. Allowances are established for potential product returns and credit losses. If a license of software requires customer acceptance, revenue is recognized upon the earlier of customer acceptance or the expiration of the acceptance period. To date, revenues from license fees has been less than ten percent of total revenues

ADVERTISING EXPENSES The Company expenses advertising costs as incurred. Advertising expenses for fiscal 2000, 1999 and 1998 were approximately \$6 million, \$4 million and \$6 million respectively.

STRATEGIC DEVELOPMENT AGREEMENTS Net engineering, research and development expenses were partially offset by \$16 million, \$14 million and \$11 million in external funding received under certain strategic development programs conducted with several of the Company's customers in fiscal 2000, 1999 and 1998, respectively.

INCOME TAXES KLA-Tencor accounts for income taxes under an asset and liability approach. Deferred tax liabilities are recognized for future taxable amounts and deferred tax assets are recognized for future deductions, net of a valuation allowance to reduce deferred tax assets to amounts that are more likely than not to be realized.

EARNINGS PER SHARE Basic earnings per share is computed by dividing net income available to common stockholders by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by using the weighted average number of common shares outstanding during the period and gives effect to all dilutive potential common shares outstanding during the period. The reconciling difference between the computation of basic and

diluted earnings per share for all periods presented is the inclusion of the dilutive effect of stock options issued to employees under employee stock option plans.

Options to purchase 211,009, 1,520,574 and 2,157,416 shares were outstanding at June 30, 2000, 1999 and 1998 respectively, but not included in the computation of diluted EPS because the exercise price was greater than the average market price of common shares in each respective year. The exercise price ranges of these options were \$56.31 to \$68.00, \$21.13 to \$34.94 and \$24.03 to \$34.94 at June 30, 2000, 1999 and 1998, respectively.

STOCK-BASED COMPENSATION PLANS The Company accounts for its employee stock option plans and employee stock purchase plan in accordance with provisions of the Accounting Principles Board's Opinion No. 25, "Accounting for Stock Issued to Employees." The Company provides additional proforma disclosure required by SFAS No. 123, "Accounting for Stock-Based Compensation" (see Note 6).

RECLASSIFICATIONS Certain amounts in fiscal years prior to 2000 have been reclassified to conform to the 2000 financial statement presentation.



RECENT ACCOUNTING PRONOUNCEMENTS In June 1999, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 137 (SFAS No. 137), "Accounting for Derivative Instruments and Hedging Activities - Deferral of the Effective Date of FASB Statement No. 133." SFAS No. 137 amends Statement of Financial Accounting Standards No. 133 (SFAS No. 133), "Accounting for Derivative Instruments and Hedging Activities," to defer its effective date to all fiscal quarters of all fiscal years beginning after June 15, 2000. SFAS No. 133 establishes accounting and reporting standards for derivative instruments including standalone instruments, such as forward currency exchange contracts and interest rate swaps or embedded derivatives, such as conversion options contained in convertible debt investments and requires that these instruments be marked-to-market on an ongoing basis. Along with the derivatives, the underlying hedged items are also to be marked-to-market on an ongoing basis. These market value adjustments are to be included either in the income statement or in stockholders' equity, depending on the nature of the transaction. The Company currently only participates in hedge transactions of assets, liabilities and firm commitments and does not anticipate that the adoption of this Statement will have a material impact on the financial statements as the gains and losses on the hedge transactions offset the losses and gains on the underlying items being hedged. The Company is required to adopt SFAS No. 133 in the first quarter of our fiscal year ending June 30, 2001. The effect of adopting SFAS No. 133 is not expected to be material to the Company's financial statements.

In March 2000, the FASB issued interpretation No. 44 (FIN 44), "Accounting for Certain Transactions Involving Stock Compensation - an Interpretation of APB 25." This Interpretation clarifies the FASB's views in applying Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees" to certain stock compensation awards. FIN 44 is effective July 1, 2000, however certain conclusions in this Interpretation cover specific events that occur after December 15, 1998. To the extent this Interpretation covers events occurring during the period after December 15, 1998, but before the effective date of July 1, 2000, the effects of applying

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this Interpretation are recognized on a prospective basis from July 1, 2000. The implementation of FIN 44 is not expected to have any material impact on the Company's financial statements.

In June 2000, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 101B (SAB 101B), "Second Amendment: Revenue Recognition in Financial Statements." SAB 101B amends Staff Accounting Bulletin No. 101 (SAB 101) "Revenue Recognition in Financial Statements," to defer the implementation date of SAB 101 for registrants until no later than the fourth fiscal quarter of fiscal years beginning after December 15, 1999. SAB 101 summarizes certain of the SEC's views in applying generally accepted accounting principles to revenue recognition in financial statements of all public companies. The Company is required to adopt SAB 101 in the fourth quarter of its fiscal year ending June 30, 2001. Accordingly, any shipments previously reported as revenue, including revenue reported for the first three quarters of fiscal 2001, that do not meet SAB 101's guidance will be recorded as revenue in future periods. Changes in our revenue recognition policy resulting from the interpretation of SAB 101 would not involve the restatement of prior fiscal year statements, but would, to the extent applicable, be reported as a change in accounting principle in the fiscal year ending June 30, 2001, with the appropriate restatement of interim periods as required by SFAS No. 3 "Reporting Accounting Changes in Interim Financial Statements." The Company's reported results of operations for the 12 months ending June 30, 2001 will include a cumulative adjustment for all prior annual and interim periods including an adjustment for revenue reported in the first quarter of fiscal 2001 as if SAB 101 had been adopted on July 1, 2000. The Company, in conjunction with the semiconductor capital equipment industry association is seeking clarification on the requirements of SAB 101 as they relate to the semiconductor capital equipment industry. Management believes that SAB 101 and 101B, to the extent that they impact us, will not affect the underlying strength or weakness of our business operations as measured by the dollar value of our product shipments and cash flows.

NOTE 2 - FINANCIAL STATEMENT COMPONENTS

BALANCE SHEETS

June 30, (in thousands)	1999	2000
Accounts receivable, net		
Accounts receivable, gross	\$ 296,708	\$ 496,739
Allowance for doubtful accounts	(16,638)	(14,789)
	\$ 280,070	\$ 481,950
Inventories:		
Customer service parts	\$ 41,276	\$ 54,442
Raw materials	45,906	83,103
Work-in-process	52,913	82,922
Demonstration equipment	37,469	50,817
Finished goods	18,115	11,205
	\$ 195,679	\$ 282,489

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Property and equipment:		
Land	\$ 16,187	\$ 16,187
Buildings and improvements	30,370	20,860
Machinery and equipment	183,135	183,985
Office furniture and fixtures	24,742	26,977
Leasehold improvements	64,461	94,466
	318,895	342,475
Less: accumulated depreciation and amortization	(150,560)	(142,756)
	\$168,335	\$ 199,719
Other current liabilities:		
Warranty, installation and retrofit	\$ 44,665	\$ 79,874
Compensation and benefits	122,851	180,365
Unearned revenue	20,055	22,412
Income taxes payable	59,934	88,037
Restructuring accrual	16,930	1,686
Other accrued expenses	38,066	67,437
	\$302,501	\$ 439,811
Accumulated other comprehensive income:		
Currency translation adjustments	\$ (6,048)	\$ (3,146)
Unrealized gains on investments, net	11,231	16,811
	\$ 5,183	\$ 13,665

STATEMENTS OF OPERATIONS

Year ended June 30, (in thousands)	1998	1999	2000
Interest income and other, net			
Interest income	\$ 42,588	\$ 38,403	\$ 39,335
Interest expense	(3,166)	(1,293)	(698)
Foreign exchange gain	248	1,136	3,791
Realized gain/(loss) on sale of securities	---	18,819	(5,306)
Other	2,010	3,578	4,414

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\$ 41,680 \$ 60,643 \$ 41,536  
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NOTE 3 - NON-RECURRING ACQUISITION, RESTRUCTURING AND OTHER CHARGES

ACQUISITIONS

For the year ended June 30, 2000

In March 2000, we purchased assets and related technology of Fab Solutions, a division of ObjectSpace, Inc., for an aggregate purchase price of \$8 million. Fab Solutions is a leading provider of advanced process control software solutions used to respond to yield-impacting parametric data in near-real time. We recorded a charge of \$0.8 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In February 2000, we acquired software developer FINLE Technologies, Inc., a supplier of lithography modeling and data analysis software used to speed development of advanced lithography processes required to develop and produce integrated circuits with 0.12 micron and smaller geometries, for an aggregate purchase price of \$5 million. We recorded a charge of \$0.5 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In November 1999, we acquired software developer ACME Systems, Inc., a leading supplier of yield engineering analysis software used to correlate parametric electrical test and wafer sort yield data with in-line Work In Process and Metrology data, for an aggregate purchase price of \$6.9 million. We recorded a charge of \$1.9 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

To determine the value of the in-process technology of the fiscal 2000 acquisitions, the expected future cash flow attributable to the in-process technology was discounted, taking into account the percentage of completion, utilization of pre-existing technology, risks related to the characteristics and applications of the technology, existing and future markets, and technological risk associated with completing the development of the technology. The valuation approach used was a form of discounted cash flow approach commonly known as the "percentage of completion" approach whereby the cash flows from the technology are multiplied by the percentage of completion of the in-process technology. In each acquisition, the value of tangible net assets acquired was nominal.

For the year ended June 30, 1999

In December 1998, the Company purchased a confocal review station product and related technology from Uniphase Corporation for an aggregate purchase price of \$3 million. Assets acquired of \$3 million consisted primarily of inventory.

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In November 1998, the Company purchased assets and technology from Keithley Instruments, Inc. for an aggregate purchase price of \$10 million. The corona wire gate oxide monitoring tool technology we acquired had not yet reached the alpha stage and the cost to complete the development of this equipment was estimated at the time of acquisition to be \$1 million. The Company recorded a charge of \$8 million for purchased in-process research and development, representing the appraised value of product that was not considered to have reached technological feasibility.

In June 1998, we acquired Groff Associates, Inc. (dba VARS Inc.) for an aggregate purchase price of \$13 million. The digital and in-line-monitoring image archiving retrieval software technology we acquired had not yet reached the alpha stage and the cost to complete the development of these software products was estimated at the time of acquisition to be \$2 million. We recorded a charge of \$13 million for purchased in-process research and development, representing the appraised value of products that were not considered to have reached technological feasibility.

In May 1998 we acquired DeviceWare, Inc., a company in its development stage, for an aggregate purchase price of \$3 million. The bit mapping defect characterization technology acquired had not yet reached the alpha stage and the cost to complete the development of this software product was estimated at the time of acquisition to be \$1 million. We recorded a charge of \$3 million for purchased in-process research and development, representing the appraised value of product that was not considered to have reached technological feasibility.

For each of the above three fiscal 1999 transactions, the appraised value under the income approach used for our calculation did not differ materially from the result under the percentage of completion approach preferred by the Securities and Exchange Commission. The value of the tangible net assets acquired was nominal.

Each of the above acquisitions was accounted for using the purchase method of accounting and the developmental products acquired were evaluated in the context of Interpretation 4 of SFAS No. 2 and SFAS No. 86. The allocation of the purchase price to in-process research and development cost was determined by identifying research projects in areas for which technological feasibility had not been established and no alternative future uses existed. Substantially all of the in-process research and development projects acquired were expected to be complete and generating revenues within the 24 months following the acquisition date.

For the year ended June 30, 1998

In February 1998, we acquired Nanopro GmbH (Freiburg, Germany) for an aggregate purchase price of \$3 million. This privately-held company specialized in the development of advanced interferometric wafer inspection. The identified in-process research and development of \$3 million was estimated and expensed, because technological feasibility of the advanced interferometric wafer technology had not yet been reached. The appraised value under the income approach used for our calculation did not differ materially from the result under the percentage of completion approach preferred by the Securities and Exchange Commission. The technology

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acquired had not reached commercial feasibility as of June 30, 1999. The value of the tangible net assets acquired was nominal.

In April 1998, we acquired Amray, Inc. (Amray) for 1,800,000 shares of our common stock accounted for under the pooling of interest method of accounting. A privately-owned provider of scanning electron microscope systems, Amray's historical operations, net assets, and cash flows were less than 3% of our consolidated financial results and, therefore, were not reflected in the consolidated financial results prior to the acquisition.

Development of acquired technologies remains a significant risk due to the remaining effort required to achieve technical feasibility, rapidly changing customer markets and significant competitive threats from numerous companies. Failure to bring any of these products to market in a timely manner could adversely affect our sales and profitability in the future. Additionally, the value of net assets and other intangible assets acquired may become impaired.

#### RESTRUCTURING AND OTHER CHARGES

In November 1998, the Company entered into a restructuring plan to address the downturn in the semiconductor industry. The plan included a consolidation of facilities, a write-down of assets associated with affected programs and a reduction in the Company's global workforce, resulting in a restructuring charge of \$35 million. Restructuring costs have been assigned to four main categories including facilities, inventory, severance and benefits, and other restructuring charges. Facilities costs totaling \$12 million include \$8 million for lease expense resulting from consolidation and closure of certain offices located primarily in the U.S. and Japan; \$3 million for leasehold improvements in those facilities; and \$1 million in other facilities-related exit costs. Inventory-related costs of \$10 million are assets related to unique parts and non-cancelable purchase commitments of certain development programs which were terminated as part of the realignment and streamlining of the Company's product lines. Severance and benefit-related costs totaling \$8 million included involuntary termination of approximately 250 personnel from manufacturing, engineering, sales, marketing, and administration throughout the U.S., Japan and Europe during fiscal 1999. Other restructuring costs of \$5 million relate primarily to the write-off of software licenses and related non-cancelable maintenance contracts for closed locations.

During fiscal year 2000, KLA-Tencor management determined that \$7.8 million of the restructure reserve would not be utilized because of a change in management's plans for utilization of certain facilities resulting from an increase in demand for the Company's products. Accordingly, the restructuring reserve reversal was included in the determination of income from operations for the year ended June 30, 2000.

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The following table sets forth the restructuring reserve since inception:

(in thousands)	Facilities	Inventory	Severance and Benefits	Other	Total
Restructuring provision - November 1998	\$ 12,491	\$ 9,721	\$ 8,126	\$ 4,662	\$ 35,000
Write-down of assets	(2,035)	(6,729)	--	(3,168)	(11,932)
Cash expenditure	(2,109)	(409)	(2,620)	(1,000)	(6,138)
Balance at June 30, 1999	8,347	2,583	5,506	494	16,930
Write-down of assets	(326)	(2,304)	(339)	(494)	(3,463)
Non-cash stock compensation	--	--	(2,952)	--	(2,952)
Cash expenditure	(398)	--	(593)	--	(991)
Reserve Reversal	(6,978)	(279)	(581)	--	(7,838)
Balance at June 30, 2000	\$ 645	\$ --	\$ 1,041	\$ --	\$ 1,686

The remaining balance at June 30, 2000 consists of payments under certain contractual obligations which existed as of the date of the plan was executed and certain severance agreements.

#### NOTE 4 - INVESTMENTS

The amortized costs and estimated fair value of securities available for sale as of June 30, 1999 and 2000 are as follows:

June 30, 1999 (in thousands)	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Fair Value
U.S. Treasuries	\$ 53,097	\$ 85	\$ 728	\$ 52,454
Mortgage-backed securities	40,522	51	421	40,152
Municipal bonds	386,719	1,358	2,416	385,661
Corporate debt securities	63,880	18	517	63,381
Corporate equity securities	5,931	21,164	--	27,095
Other	93,075	123	357	92,841
	643,224	22,799	4,439	661,584
Less: Cash equivalents	177,891	--	2	177,889
Short-term investments	38,361	21,232	19	59,574
Long-term investments	\$ 426,972	\$ 1,567	\$ 4,418	\$ 424,121

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June 30, 2000 (in thousands)	Gross Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Gross Fair Value
------------------------------	----------------------------	------------------------------	-------------------------------	------------------------

U.S. Treasuries	\$ 33,545	\$ 24	\$ 348	\$ 33,221
Mortgage-backed securities	37,282	2	663	36,621
Municipal bonds	580,328	633	1,236	579,725
Corporate debt securities	187,919	28	563	187,384
Corporate equity securities	26,047	14,427	45	40,429
Other	33,216	--	--	33,216
	-----	-----	-----	-----
	898,337	15,114	2,855	910,596
Less: Cash equivalents	424,429	--	4	424,425
Short-term investments	105,569	14,455	92	119,932
	-----	-----	-----	-----
Long-term investments	\$ 368,339	\$ 659	\$ 2,759	\$ 366,239
	=====	=====	=====	=====

The contractual maturities of securities classified as available for sale as of June 30, 2000, regardless of the consolidated balance sheet classification, are as follows:

June 30, 2000 (in thousands)	Estimated Fair Value
-----	-----
Due within one year	\$ 528,685
Due after one year through five years	278,717
Due after five years	62,765
	-----
	\$ 870,167
	=====

Actual maturities may differ from contractual maturities because borrowers may have the right to call or prepay obligations with or without call or prepayment penalties. Net realized gains and losses for the years ended June 30, 1999 and 2000 were not material to the Company's financial position or results of operations.

#### NOTE 5 - INCOME TAXES

The components of income before income taxes are as follows:

Year ended June 30, (in thousands)	1998	1999	2000
-----	-----	-----	-----
Domestic income before income taxes	\$ 172,964	\$ 30,097	\$ 311,240
Foreign income before income taxes	33,347	20,212	41,837
	-----	-----	-----
Total net income before taxes	\$ 206,311	\$ 50,309	\$ 353,077
	=====	=====	=====

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The provision (benefit) for income taxes are comprised of the following:

Year ended June 30, (in thousands)	1998	1999	2000
-----	-----	-----	-----
Current:			
Federal	\$ 94,402	\$ 22,902	\$ 121,639
State	13,598	7,040	23,187
Foreign	10,440	9,085	14,975
	-----	-----	-----
	118,440	39,027	159,801
Deferred:			
Federal	(42,149)	(22,256)	(44,893)
State	(4,376)	(6,273)	(13,958)
Foreign	300	599	(1,671)
	-----	-----	-----
	(46,225)	(27,930)	(60,522)

Provision for income taxes	\$ 72,215	\$ 11,097	\$ 99,279
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Actual current tax liabilities are lower than reflected above for fiscal years 1998, 1999 and 2000 by \$21 million, \$14 million and \$132 million, respectively, due to the stock option deduction benefits recorded as credits to capital in excess of par value.

The significant components of deferred income tax assets (liabilities) are as follows:

June 30, (in thousands)	1999	2000
Deferred tax assets:		
Federal and state loss and credit carryforwards	\$ 5,231	\$ 37,796
Employee benefits accrual	27,889	32,834
Non-deductible reserves and other	119,035	144,065
	152,155	214,695
Deferred tax liabilities:		
Depreciation	(6,202)	(7,473)
Unremitted earnings of foreign subsidiaries not permanently reinvested	(12,138)	(12,070)
Unrealized gain on investments	(7,104)	(10,613)
Other	(2,840)	(4,952)
	(28,284)	(35,108)
Deferred tax assets valuation allowance	(1,298)	--
Total net deferred tax assets	\$ 122,573	\$ 179,587

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The reconciliation of the United States federal statutory income tax rate to the Company's effective income tax rate is as follows:

Year ended June 30,	1998	1999	2000
Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.9	1.0	1.7
Effect of foreign operations taxed at various rates	(0.1)	4.8	(0.6)
Benefit from Foreign Sales Corporation	(2.8)	(3.3)	(2.9)
Research and development tax credit	(1.7)	(1.2)	(2.5)
Merger and acquisition costs	3.0	--	--
Tax exempt interest	(2.6)	(11.8)	(1.6)
Other	1.3	(2.4)	(1.0)
Provision for Income Taxes	35.0%	22.1%	28.1%

Undistributed earnings of certain of the Company's foreign subsidiaries, for which no United States federal income taxes have been provided, aggregated \$20 million at June 30, 2000. The amount of the unrecognized deferred tax expense related to the investments in foreign subsidiaries is estimated at \$5.5 million at June 30, 2000.

The IRS is currently auditing the Company's federal income tax returns for fiscal 1995 to 1996. Management believes sufficient taxes have been provided in prior years and that the ultimate outcome of the IRS audits will not have a material adverse impact on the Company's financial position or results of operations.

#### NOTE 6 - STOCKHOLDERS' EQUITY AND EMPLOYEE BENEFITS

STOCKHOLDER'S RIGHTS PLAN In March 1989, the Company implemented a plan to protect stockholders' rights in the event of a proposed takeover of the Company. The Plan was amended in April, 1996. The Plan provides that if any

person or group acquires 15% or more of the Company's common stock, each Right not owned by such person or group will entitle its holder to purchase, at the then-current exercise price, the Company's common stock at a value of twice that exercise price. As amended to date, under the Plan, the rights are redeemable at the Company's option for \$0.01 per right and expire in April 2006.

**STOCK REPURCHASE PROGRAM** In July 1997, the Board of Directors authorized the Company to systematically repurchase shares of its common stock in the open market. This plan was entered into to reduce the dilution from the Company's employee benefit and incentive plans such as the stock option and employee stock purchase plans. In fiscal years 2000, 1999 and 1998, the Company repurchased 520,000, 2,152,000 and 756,000 shares at an average price of \$53.80, \$22.66 and \$21.22 per share, respectively. At June 30, 2000, 463,200 shares are authorized for repurchase under this program.

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**STOCK SPLIT** For shareholders of record on January 4, 2000, the Company effected a two-for-one stock split of its common stock in the form of a 100 percent stock dividend. The stock dividend was paid on January 18, 2000. All prior-period share and per share amounts have been adjusted to reflect this transaction retroactively.

**EMPLOYEE STOCK PURCHASE PLAN** The Company's employee stock purchase plan provides that eligible employees may contribute up to 10% of their base earnings toward the semi-annual purchase of the Company's common stock. The employee's purchase price is derived from a formula based on the fair market value of the common stock. No compensation expense is recorded in connection with the plan. In fiscal years 2000, 1999 and 1998, employees purchased 1,935,031, 1,639,334 and 1,765,738 at a weighted average fair value of shares issued of \$13.28, \$5.24 and \$5.60, respectively. At June 30, 2000, 533,577 shares were reserved and available for issuance under this plan.

**STOCK OPTION AND INCENTIVE PLANS** The Company has authorized various stock option and management incentive plans for selected employees, officers, directors, and consultants. The plans provide for awards in the form of stock options, stock appreciation rights, stock purchase rights, and performance shares. As of June 30, 2000, only stock options have been awarded under the plans.

Under the Company's stock option plans, options generally have vesting periods of four years, are exercisable for a period not to exceed ten years from the date of issuance and are granted at prices not less than the fair market value of the Company's common stock at the grant date.

In August 1998, employees of the Company, excluding certain executive officers, holding options with exercise prices of \$14.00 or higher were granted the opportunity to surrender those options and replace them with new options having an exercise price of \$10.63, the fair market value of the Company's stock on that date, and begin a new vesting schedule from the date of grant. In addition, in October 1998, certain executive officers were granted the opportunity to surrender their options and replace them with a reduced number of options having an exercise price of \$16.97, the fair market value on that date, and begin a new vesting schedule from the date of grant. A total of 8,359,934 options were repriced.

The activity under the option plans, combined, was as follows:

	Available For Grant	Options Outstanding	Weighted- Average Price
Balances at June 30, 1997	4,251,676	20,521,932	\$ 10.33
Additional shares reserved	5,003,206	--	--
Options granted	(7,259,776)	7,259,776	23.22
Options canceled/expired	1,503,420	(1,831,828)	15.28
Options exercised	--	(2,760,350)	5.17

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Balances at June 30, 1998	3,498,526	23,189,530	14.56
Additional shares reserved	7,237,674	--	--
Options granted	(15,311,226)	15,311,226	12.12
Options canceled/expired	11,083,092	(11,083,092)	21.03
Options exercised	--	(2,989,360)	7.71
-----			
Balances at June 30, 1999	6,508,066	24,428,304	10.92
Additional shares reserved	5,320,924	--	--
Options granted	(8,165,856)	8,165,856	37.35
Options canceled/expired	1,483,568	(1,551,794)	18.62
Options exercised	--	(8,686,654)	9.50
-----			
Balances at June 30, 2000	5,146,702	22,355,712	\$ 20.23
=====			

The options outstanding at June 30, 2000 have been segregated into ranges for additional disclosure as follows:

Options Outstanding				Options Vested and Exercisable	
Range of Exercise Prices	Number of Shares Outstanding at June 30, 2000	Weighted-Average Remaining Contract Life (in years)	Weighted-Average Exercise Price at June 30, 2000	Number Vested and Exercisable	Weighted-Average Exercise Price at June 30, 2000
\$ 1.75-\$ 8.81	727,658	3.99	\$ 5.54	727,658	\$ 5.54
\$ 8.88-\$ 9.31	1,226,738	4.24	\$ 9.29	1,161,303	\$ 9.30
\$ 9.53-\$10.63	8,590,944	8.12	\$ 10.60	2,968,640	\$ 10.55
\$10.81-\$11.03	1,659,496	6.33	\$ 10.85	733,514	\$ 10.85
\$11.23-\$16.97	1,536,149	7.92	\$ 15.71	680,713	\$ 14.98
\$17.03-\$31.47	1,616,098	8.48	\$ 24.81	452,484	\$ 22.62
\$33.75-\$33.75	5,450,764	9.33	\$ 33.75	--	\$ --
\$34.94-\$68.00	1,547,865	9.65	\$ 51.32	53,437	\$ 45.55
-----					
\$ 1.75-\$68.00	22,355,712	8.05	\$ 20.23	6,777,749	\$ 11.36
=====					

The weighted average fair value of options granted in fiscal years 2000, 1999 and 1998 was \$24.15, \$7.47 and \$13.18, respectively. Options exercisable were 6,777,749, 7,484,476 and 10,223,824 as of June 30, 2000, 1999 and 1998, respectively.

ACCOUNTING FOR STOCK-BASED COMPENSATION Pro forma information regarding net income and net income per share is required by SFAS 123, and has been determined as if the Company had accounted for its employee stock purchase plan and employee stock options granted subsequent to June 30, 1995, under the fair value method of SFAS 123. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model for the single option approach with the following weighted-average assumptions:

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June 30,	1998	1999	2000
-----			
Stock option plan:			
Expected stock price volatility	55.0%	65.0%	70.0%
Risk free interest rate	5.8%	5.0%	6.3%
Expected life of options (in years)	5.6	5.6	5.3
Stock purchase plan:			
Expected stock price volatility	55.0%	65.0%	70.0%
Risk free interest rate	5.4%	4.8%	6.3%
Expected life of options (in years)	1-2	1-2	1-2

The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility. Because the Company's employee stock option and employee stock purchase plans have characteristics significantly different from those of traded options, and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of such Company options.

For purposes of pro forma disclosures required by SFAS 123, the estimated fair value of the options is amortized to expense over the options' vesting periods. The Company's pro forma information is as follows:

Year ended June 30, (in thousands, except per share data)	1998	1999	2000
Pro-forma net income	\$ 106,882	\$ 5,278	\$ 197,610
Pro-forma earnings per share:			
Basic	\$ 0.63	\$ 0.03	\$ 1.08
Diluted	\$ 0.62	\$ 0.03	\$ 1.05

The pro forma effect on net income and earnings per share for fiscal years 2000, 1999 and 1998 is not representative of the pro forma effect net income in future years because it does not take into consideration pro forma compensation expense related to grants made prior to fiscal 1996.

**OTHER EMPLOYEE BENEFIT PLANS** The Company has a profit sharing program for eligible employees which distributes, on a quarterly basis, a percentage of pretax profits. In addition, the Company has an employee savings plan that qualifies as a deferred salary arrangement under Section 401(k) of the Internal Revenue Code. During fiscal years 1998 and 1999, the Company matched dollar-for-dollar up to \$500 of an eligible employee's contribution. During fiscal year 2000, the Company matched \$0.25 per dollar up to \$1000 of an eligible employee's contribution, with \$500 of

the amount funded from the profit sharing program. The total charge to operations under the profit sharing and 401(k) programs aggregated \$38 million, \$7 million and \$22 million in fiscal years 2000, 1999 and 1998, respectively.

The Company has a non-qualified deferred compensation plan whereby certain key executives may defer a portion of their salary and bonus. Participants direct the investment of their account balances among mutual funds selected by the participants. Distributions from the plan commence the quarter following a participant's retirement or termination of employment. At June 30, 2000, the Company had a deferred compensation liability under the plan of \$54 million.

**NOTE 7 - COMMITMENTS AND CONTINGENCIES**

**FACTORING** The Company has an agreement with a bank to sell, with recourse, certain of its trade receivables. The total amount of the facility is the yen equivalent of \$80 million based upon exchange rates as of June 30, 2000. During fiscal 2000, approximately \$83.4 million of receivables were sold under this arrangement. As of June 30, 2000, approximately \$51.9 million were outstanding. The Company does not believe it is materially at risk for any losses as a result of this agreement.

**LINE OF CREDIT** The Company has revolving lines of credit with two banks, which expire at various dates through October 2000 under which the Company can borrow up to \$30 million. The first line, for \$15 million, bears interest at LIBOR plus 0.85% (7.46% at June 30, 2000). The second line, for \$15 million, bears interest at the higher of the announced base rate or the Fed

funds rate plus 0.5% (7.0% at June 30, 2000). At June 30, 2000, no amounts were outstanding.

**FACILITIES** In November 1997, the Company entered into a master operating lease for land, office and manufacturing facilities constructed for its use in Milpitas and San Jose, California. Monthly payments under this lease vary based upon the London Interbank Offering Rate (LIBOR) plus 0.42%. The Lease runs through November of 2002, with an option to extend up to two more years. Under the terms of the lease, the Company, at its option, can acquire the properties at their original cost or arrange for the properties to be acquired. In April 1999, the Company chose to exercise its option to purchase certain of the land and facilities for a total aggregate value of approximately \$27.4 million. If the Company does not purchase the remaining properties by the end of the lease, the Company will be contingently liable to the lessor for residual value guarantees aggregating up to approximately \$100.2 million. In addition, under the terms of the lease, the Company must maintain compliance with certain financial covenants. As of June 30, 2000, the Company was in compliance with all of its covenants. Based on current market conditions, management does not believe that the Company will have to make any significant payments under the contingent liability relating to the residual value guarantees.

The Company leases several other facilities under operating leases that expire at various times through fiscal 2012, with renewal options at the fair market value for additional periods up to five years. The Company also leases equipment and other facilities under operating leases.

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Total rent expense under all operating leases was approximately \$17.5 million, \$17.7 million and \$17.5 million for the years ended June 30, 2000, 1999 and 1998, respectively (which includes lease payments for the Company's Milpitas and San Jose, California facilities).

Future minimum lease commitments under these operating leases at June 30, 2000 (which include estimated lease payments for the Company's Milpitas and San Jose, California, facilities using a LIBOR of 7.17% and total construction costs of \$119.3 million), are approximately \$17.5 million, \$15.6 million, \$7.4 million, \$3.1 million, \$2.0 million, and \$4.5 million in fiscal 2001 through 2005 and thereafter, respectively.

**LAND PURCHASE** In May 2000, the Company entered into an agreement to purchase up to 43 acres of land in Livermore, California to build a new campus. The initial 31 acre parcel of land is scheduled to be purchased in the first quarter of fiscal 2001, for approximately \$15.1 million (See Note 10). The Company holds an option to purchase the remaining 12 acres for approximately \$5.7 million, which expires at the end of calendar 2001. The Company is obligated for assessments not to exceed approximately \$3.4 million and \$1.3 million for construction on the 31 acre and 12 acre lots, respectively.

**LEGAL MATTERS** From time to time the Company is named as a party to lawsuits in the normal course of our business. Litigation, in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. The Company believes that it has defenses in each of the cases set forth below and are vigorously contesting each of these matters.

Therma-Wave, Inc.

**Therma-Wave I:** On September 3, 1998, we initiated a patent infringement suit against Therma-Wave, Inc. alleging that certain products manufactured by Therma-Wave infringe a patent relating to film thickness measuring technology. On January 14, 1999, Therma-Wave filed a counterclaim against KLA-Tencor for patent infringement with respect to one of its thin film technology patents. We believe that the allegations contained in the counterclaim are unfounded and intend to vigorously defend our position, and we have meritorious defenses to those counterclaims. We believe that even if the outcome of the litigation is adverse to us it will not have a material adverse effect on our business, financial condition or results of operations.

**Therma-Wave II:** On July 22, 1999, we filed a second action against Therma-Wave in which we alleged that Therma-Wave infringes another patent relating to thin film thickness measuring technology. We are seeking damages and an injunction to stop the sale of the equipment that employs the infringing technology. On October 25, 1999, Therma-Wave filed a counterclaim against KLA-Tencor for patent infringement with respect to two patents relating to

optical measurement systems. The counterclaim also includes allegations that KLA-Tencor engaged in a pattern of conduct designed to disparage and improperly damage Therma-Wave. We believe that the allegations contained in the counterclaim are unfounded, we intend to vigorously defend our position, and we have meritorious defenses to those counterclaims. We believe that the outcome

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from such litigation, even if adverse to us, would not have a material adverse effect on our business, financial condition or results of operations.

Schlumberger, Inc. and Rigg Systems

On August 30, 1999, we were named as a defendant in a lawsuit in which Schlumberger, Inc. alleges trade secret misappropriation, unfair competition and trade slander. On July 21, 2000, the court granted our motion for summary judgment dismissing the case. Schlumberger, Inc. subsequently filed a motion for reconsideration of that dismissal and we are awaiting a ruling on that motion. Although the outcome of these claims cannot be predicted with certainty, we do not believe that this legal matter will have a material adverse effect on our financial condition even if plaintiff prevails. On January 26, 2000, we filed a complaint against Philip Rigg, RIGG Systems and Schlumberger, Inc. for misappropriation of trade secrets, breach of contract, breach of fiduciary duty, interference with contract, and unfair competition. The defendants filed cross-complaints on June 5, 2000 asserting various statutory and common law theories. Although the outcome of these claims cannot be predicted with certainty, we do not believe that this legal matter will have a material adverse effect on our financial condition or results of operations even if the plaintiff prevails.

#### NOTE 8 -- SEGMENT REPORTING AND GEOGRAPHIC INFORMATION

In fiscal 1999, the Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for reporting information about operating segments in annual financial statements and requires that certain selected information about operating segments be reported in interim financial reports. It also establishes standards for related disclosures about products and services, and geographic areas. Operating segments are defined as components of an enterprise about which separate financial information is evaluated regularly by the chief operating decision maker, or decision-making group, in deciding how to allocate resources and in assessing performance. The Company's chief operating decision makers are the Chief Executive Officer and the Chief Operating Officer. SFAS No. 131 differs from the previous accounting standard SFAS No. 14, which required companies to disclose certain financial information about each industry segment in which they operate.

The Company is engaged primarily in designing, manufacturing, and marketing yield management and process monitoring systems for the semiconductor industry. All operating units have been aggregated due to their inter-dependencies, commonality of long-term economic characteristics, products and services, the production processes, class of customer and distribution processes. Since the Company operates in one segment, all financial segment information required by SFAS 131 can be found in the consolidated financial statements.

The Company's significant operations outside the United States include a manufacturing facility in Israel and sales, marketing and service offices in Western Europe, Japan, and the Asia Pacific region. For geographical reporting, revenues are attributed to the geographic location in which the customer is located. No single customer accounted for 10% or more of net revenues or accounts receivable in any of the periods presented. Long-lived assets consist of net property and equipment, goodwill, capitalized software and other intangibles, and other long-term assets,

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excluding long-term deferred tax assets and are attributed to the geographic location in which they are located. The following is a summary of operations by entities located within the indicated geographic areas for fiscal years 1998, 1999 and 2000.

Year ended June 30, (in thousands)	1998	1999	2000
<b>Revenues:</b>			
United States	\$ 513,065	\$338,791	\$ 448,022
Western Europe	147,070	133,099	222,186
Japan	291,175	198,196	309,062
Taiwan	141,895	87,883	299,442
Asia Pacific	73,120	85,212	220,100
<b>Total</b>	<b>\$1,166,325</b>	<b>\$843,181</b>	<b>\$1,498,812</b>

June 30, (in thousands)	1998	1999	2000
<b>Long-lived assets:</b>			
United States	\$ 149,776	\$183,332	\$ 240,148
Western Europe	9,062	7,785	8,059
Japan	13,044	13,068	11,012
Taiwan	1,418	1,162	2,469
Asia Pacific	3,488	3,439	5,703
<b>Total</b>	<b>\$ 176,788</b>	<b>\$208,786</b>	<b>\$ 267,391</b>

#### NOTE 9 - SUBSEQUENT EVENT

On August 15, 2000, the Company closed on the purchase of a 31 acre parcel of land in Livermore, California for approximately \$15.1 million (See Note 7). Construction on the land is scheduled to begin in the first quarter of fiscal 2001.

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#### NOTE 10 - QUARTERLY CONSOLIDATED RESULTS OF OPERATIONS (UNAUDITED)

The following table presents certain unaudited consolidated quarterly financial information for the eight quarters ended June 30, 2000. In our opinion, this information has been prepared on the same basis as the audited consolidated financial statements appearing elsewhere in this Form 10-K and includes all adjustments (consisting only of normal recurring adjustments) necessary to present fairly the unaudited quarterly results of operations set forth herein.

(In thousands, except per share data)	September 30	December 31	March 31	June 30
<b>Fiscal 1999:</b>				
Revenues	\$ 205,230	\$ 193,371	\$ 210,939	\$ 233,641
Gross profit	92,575	88,462	100,259	114,826
Income (loss) from operations	(2,924)	(42,674) (1)	12,964	22,300
Net income (loss)	10,180	(17,597) (1)	20,782	25,847
Net income (loss) per share:				
Basic	\$ 0.06	\$ (0.10) (1)	\$ 0.12	\$ 0.15
Diluted	\$ 0.06	\$ (0.10) (1)	\$ 0.11	\$ 0.14
<b>Fiscal 2000:</b>				
Revenues	\$ 272,989	\$ 330,757	\$ 413,017	\$ 482,049
Gross profit	136,872	177,384	231,645	275,106
Income from operations	42,740 (2)	61,550	91,147 (3)	116,104
Net income	39,502 (2)	49,249	73,347 (3)	91,700
Net income per share:				
Basic	\$ 0.22 (2)	\$ 0.27	\$ 0.40 (3)	\$ 0.49
Diluted	\$ 0.21 (2)	\$ 0.26	\$ 0.38 (3)	\$ 0.47

- (1) Includes non-recurring acquisition and restructuring charges of \$43 million. Net income, basic and diluted net income per share would have been \$10 million, \$0.06 and \$0.06, respectively, excluding these costs.
- (2) Includes non-recurring acquisition and restructuring charges of \$(6) million. Net income, basic and diluted net income per share would have been \$36 million, \$0.20 and \$0.19, respectively, excluding these costs.

(3) Includes non-recurring acquisition and restructuring charges of \$1 million. Net income would have been \$74 million, basic and diluted net income per share would have remained unchanged.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and Stockholders of KLA-Tencor Corporation

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, of stockholders' equity and of cash flows present fairly, in all material respects, the financial position of KLA-Tencor Corporation and its subsidiaries at June 30, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2000, in conformity with accounting principles generally accepted in the United States of America. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with auditing standards generally accepted in the United States of America which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PRICEWATERHOUSECOOPERS LLP

San Jose, California  
July 24, 2000, except as to Note 9, which is as of August 15, 2000

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ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Set forth below are the names of the present directors and executive officers of KLA-Tencor as of September 22, 2000, their ages and positions held. Additional information required by Item 405 of Regulation S-K of the Securities Act of 1933, as amended, is incorporated herein by reference to our Proxy Statement.

Name	Age	Position
Kenneth Levy	57	Chairman of the Board
Kenneth L. Schroeder	54	President and Chief Executive Officer
Gary E. Dickerson	43	Chief Operating Officer
John H. Kispert	36	Executive Vice President, and Chief Financial Officer
Dennis J. Fortino	54	Executive Vice President, Optical Surface inspection and Measurement Group
Edward C. Grady	53	Executive Vice President, Wafer Inspection Group
Samuel A. Harrell	60	Senior Vice President, Strategic Business Development
Maureen Lamb	39	Vice President, Finance and Accounting
Stuart J. Nichols	40	Vice President, General Counsel
Neil Richardson	45	Executive Vice President, E-Beam Inspection and

Arthur P. Schnitzer	57	Metrology Group
Richard P. Wallace	40	Executive Vice President, Customer Group
Edward W. Barnholt	57	Executive Vice President, Wafer Inspection Group
H. Raymond Bingham	54	Director
Robert T. Bond	57	Director
Richard J. Elkus, Jr.	65	Director
Dean O. Morton	68	Director
Jon D. Tompkins	60	Director
Lida Urbanek	55	Director

Kenneth Levy is a co-founder of KLA-Tencor and since July 1, 1999 has been Chairman of the Board and a Director. From July 1998 until June 30, 1999 he was the Chief Executive Officer and a Director. From April 30, 1997 until June 30, 1998 he was Chairman of the Board. From 1975 until April 30, 1997 he was Chairman of the Board and Chief Executive Officer. He currently serves on the boards of directors of Ultratech Stepper, Inc., SpeedFam-IPEC, Inc. and is a Director Emeritus of SEMI, an industry trade association

Kenneth L. Schroeder has been President and Chief Executive Officer and a Director of KLA-Tencor since July 1, 1999. From November 1991 until June 30, 1999, he was President and

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Chief Operating Officer and a Director. He currently serves on the boards of directors of GaSonic International and SEMI, an industry trade association.

Gary E. Dickerson has been Chief Operating Officer since July 1, 1999. Mr. Dickerson joined KLA-Tencor in January 1986 and has held a series of management positions. From July 1997 until June 30, 1999, he was Executive Vice President of the Customer Group. In January 1996, he was promoted to Group Vice President for the Wafer Inspection Group. In July 1994 he became the General Manager of the Wisard Division.

John H. Kispert became Chief Financial Officer in July 2000. Before becoming CFO, Mr. Kispert was Vice President of Finance and Accounting since July 1999. From February 1998 to July 1999 he was Vice President of Operations for the Wafer Inspection Group. From August 1997 to February 1998 he was Director of Operations. Mr. Kispert joined KLA-Tencor in February 1995 and has held a series of other management positions within the Company. Prior to KLA-Tencor, Mr. Kispert was with IBM for 6 years.

Dennis J. Fortino has been Executive Vice President of the Optical Surfscan Inspection and Measurement Group since July 1999. From August 1997 to June 1999, he served as Vice President and General Manager of the Surfscan Division and from November 1995 to July 1997 as the Vice President and General Manager of the Surface Metrology Division. Mr. Fortino served as Vice President and General Manager for Spectra-Physics Lasers from July 1991 to October 1995.

Edward C. Grady has been Executive Vice President of the Wafer Inspection Group since July 1999. From August 1998 to July 1999, he was Executive Vice President of the Precision Measurement. In March 1996 until August 1998 he was Vice President and General Management of the RAPID Division. He took held position of Vice President of Marketing in July 1995 until March 1996.

Dr. Samuel A. Harrell joined KLA-Tencor in September 1995 as Senior Vice President of Strategic Business Development. Dr. Harrell is responsible for strategic corporate development. Dr. Harrell served from October 1992 to December 1995 as the Senior Vice President and Chief Strategy Officer of SEMATECH. From August 1987 to September 1992 he served as President of SEMI/SEMATECH.

Maureen Lamb became Vice President, Finance and Accounting in July 2000. She was the Corporate Controller from January 1999 to July 2000.

Stuart J. Nichols joined KLA-Tencor in October 1999 as Vice President, General Counsel. Before KLA-Tencor, Mr. Nichols served from May 1997 to October 1999 as Vice President, General Counsel and Secretary of Phoenix Technologies Ltd. Mr. Nichols also served as General Counsel of Samsung Semiconductor, Inc. from August 1995 to May 1997.

Dr. Neil Richardson has been Executive Vice President of E-Beam Inspection and Metrology Group since May 1998. He was Executive Vice President

of the Metrology Group from February

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1997 to April 1998. He joined KLA-Tencor in June 1993 as Vice President and General Manager of the Metrology Division.

Arthur P. Schnitzer has been Executive Vice President of the Customer Group since November 1998. From June 1997 to October 1998 he was Executive Vice President, Human Resources. From July 1993 to June 1997 he was Group Vice President responsible for RAPID, SEMSPEC, PRISM and manufacturing for WISARD and RAPID. From 1989 to July 1993 he was Vice President and General Manager of the Wisard division. He joined KLA-Tencor in July 1978 and has held a series of other management positions within the Company.

Richard P. Wallace became Executive Vice President of the Wafer Inspection Group in July 1999. From July 1999 to June 2000, he was the Group Vice President for Lithography and Films. From April 1998 to June 1999 he was Vice President and General Manager of the Mirage Group. From 1995 to March 1998 he was Vice President and General Manager of the Wisard division. Mr. Wallace joined KLA-Tencor in 1988 and has held a series of other management positions.

Edward W. Barnholt has been a Director of the Company since 1995. Since May 1999, he has been President and Chief Executive Officer and a director of Agilent Technologies, Inc. Mr. Barnholt served as General Manager of Hewlett-Packard's Measurement Organization from 1998 to 1999, which included Hewlett-Packard's Electronic Instruments Group, the Microwave and Communications Group, the Communications Test Solutions Group, the Automated Test Group, the Chemical Analysis Group, the Components Group and the Medical Products Group. From 1990 to 1998, he served as General Manager of Hewlett-Packard's Test and Measurement Organization. He was elected a Senior Vice President of Hewlett-Packard in 1993 and an Executive Vice President in 1996.

H. Raymond Bingham has been a Director of the Company since August 2000. He has been President and Chief Executive Officer of Cadence Design Systems, Inc. since April 1999. Mr. Bingham has been a director of Cadence since November 1997. From 1993 to April 1999, Mr. Bingham served as Executive Vice President and Chief Financial Officer of Cadence. Prior to joining Cadence, Mr. Bingham was Executive Vice President and Chief Financial Officer of Red Lion Hotels and Inns, an owner and operator of a chain of hotels, for eight years. Mr. Bingham is a director of Legato Systems, Inc., Onyx Software Corporation, TenFold Corporation and a director and Chairman of Integrated Measurement Systems, Inc.

Robert T. Bond has been a Director of the Company since August 2000. From April 1996 to January 1998, Mr. Bond served as Chief Operating Officer of Rational Software Corporation. Prior to that, he held various executive positions at Rational Software Corporation. Mr. Bond was employed by Hewlett-Packard Company from 1967 to 1983 and held various management positions during his tenure there. He is on the Advisory Board of Cyntic Corporation and is also a director. He also serves on the Advisory Board of Grid Data Corporation.

Richard J. Elkus, Jr. has been a Director of KLA-Tencor since April 1997. He was Executive Vice President and Vice Chairman of the board of directors of Tencor from February 1994 until April 1997. He is the Co-Chairman of the Board and a Director of Voyan Technology. He currently serves on the boards of directors of Sopra, S.A., a semiconductor equipment company, Lam Research Corporation, and Virage Logic, Corporation.

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Dean O. Morton has been a Director of the Company since April 1997. From June 1993 until April 1997 he was a Director of Tencor. In October 1992 Mr. Morton retired as Executive Vice President, Chief Operating Officer and a Director of Hewlett-Packard Company. Mr. Morton held various positions at Hewlett-Packard Company from 1960 until his retirement. Mr. Morton currently serves on the boards of directors of ALZA Corporation, The Clorox Company, BEA Systems Inc., Cepheid, and Pharsight Corporation. Mr. Morton is also a trustee of the Metropolitan Series Fund and State Street Research Funds Group and Portfolios Inc.

Jon D. Tompkins has been a Director of the Company since April 1997. He was Chairman of the Board from July 1998 to June 1999, when he retired his



position as Chairman of the Board. Mr. Tompkins has continued to serve as a Director. From April 1997 until July 1998 he was Chief Executive Officer and a Director of KLA-Tencor. From April 1991 until April 1997 he was President and Chief Executive Officer of Tencor prior to its merger with KLA. He was a Director of Tencor from 1991 until April 1997 and was appointed Chairman of the board of directors of Tencor in November 1993. He currently serves on the boards of directors of Cymer, Inc., Electro Scientific Industries, Credence Systems, Levelite, Logic Vision, and Community Foundation of Silicon Valley.

Lida Urbanek has been a Director of the Company since April 30, 1997. She is a private investor. She was a director of Tencor from August 1991 until April 30, 1997.

For additional information required by this item see "Compliance with Section 16(a) of the Securities Exchange Act of 1934" in the Proxy Statement, which is incorporated herein by reference.

#### ITEM 11. EXECUTIVE COMPENSATION

For the information required by this Item, see "Executive Compensation" in the Proxy Statement, which is incorporated herein by reference.

#### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

For the information required by this Item, see "Security Ownership - Principal Stockholders and Security Ownership of Management" in the Proxy Statement, which is incorporated herein by reference.

#### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

For the information required by this Item, see "Certain Transactions" in the Proxy Statement, which is incorporated herein by reference.

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### PART IV

#### ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) The following documents are filed as part of this Annual Report on Form 10-K:

1. Financial Statements:

The following financial statements and schedules of the Registrant are contained in Item 8 of this Annual Report on Form 10-K:

Consolidated Balance Sheets at June 30, 1999 and 2000  
Consolidated Statements of Operations for each of the  
Three Years in the Period Ended June 30, 2000  
Consolidated Statements of Stockholders' Equity for each  
of the Three Years in the Period Ended June 30,  
2000

Consolidated Statements of Cash Flows for each of the  
Three Years in the Period Ended June 30, 2000  
Notes to Consolidated Financial Statements  
Report of Independent Accountants

2. Financial Statement Schedules:

The following financial statement schedule of the Registrant is filed as part of this Annual Report on Form 10-K and should be read in conjunction with the financial statements:

Schedule II - Valuation and Qualifying Accounts

All other schedules are omitted because they are either not applicable or the required information is shown in the consolidated financial statements or notes thereto.

(b) Exhibits

EXHIBIT  
NO.  
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DESCRIPTION  
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- 3.1 Amended and Restated Certificate of Incorporation (1)
- 3.2 Bylaws, as amended November 17, 1998 (2)
- 4.1 Amended and Restated Rights Agreement dated as of August 25, 1996 between the Company and First National Bank of Boston, as Rights Agent. The Agreement includes the Form of Right Certificate as Exhibit A and the Summary of Terms of Rights as Exhibit B (3)

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- 10.1 1998 Outside Director Option Plan (4)
- 10.2 1990 Outside Directors Stock Option Plan (5)
- 10.3 Tencor Instruments 1993 Nonemployee Directors Stock Option Plan (6)
- 10.4 1997 Employee Stock Purchase Plan (7)
- 10.5 Second Amended and Restated 1981 Employee Stock Purchase Plan (8)
- 10.6 Tencor Instruments Amended and Restated 1993 Equity Incentive Plan (9)
- 10.7 1993 Employee Incentive Stock Option Plan of Prometrix Corporation (10)
- 10.8 Tencor Instruments Second Amended and Restated 1984 Stock Option Plan (11)
- 10.9 1983 Employee Incentive Stock Option Plan of Prometrix Corporation (12)
- 10.10 Restated 1982 Stock Option Plan, as amended November 18, 1996 (13)
- 10.11 Excess Profit Stock Plan (14)
- 10.12 Form of KLA-Tencor Corporation Corporate Officers Retention Plan (15)
- 10.13 Form of Retention and Non-Competition Agreement (16)
- 10.14 Form of Indemnification Agreement (17)
- 10.15 Separation Agreement between Graham Siddall and the Company (18)
- 10.16 Livermore Land Purchase and Sale Agreement
- 21.1 List of Subsidiaries
- 23.1 Consent of Independent Accountants
- 27.1 Financial Data Schedule

NOTES  
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- (1) Filed as Exhibit 3.1 to the Company's form 10-Q for the quarter ended March 31, 1997.
- (2) Filed as Exhibit 3.2 to the Company's Registration Statement on Form S-8 filed December 4, 1998, SEC File No. 333-68415.
- (3) Filed as Exhibit 1 to the Company's report on form 8-A/A, Amendment No. 2 to the Registration Statement on Form 8-A filed September 24, 1996, SEC File No. 0-9992.
- (4) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed December 4, 1998, SEC File No. 333-68423.
- (5) Filed as Exhibit 4.6 to the Company's Annual Report on Form 10-K for the year ended June

30, 1991.

- (6) Filed as Exhibit 10.3 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.

- (7) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-8 filed January 30, 1998, SEC File No. 333-45271.
- (8) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed January 30, 1998, SEC File No. 333-45271.
- (9) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (10) Filed as Exhibit 10.7 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (11) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (12) Filed as Exhibit 10.6 to the Company's Registration Statement on Form S-8 filed May 8, 1997, SEC File No. 333-26681.
- (13) Filed as Exhibit 10.74 to the Company's Registration Statement on Form S-8 filed March 7, 1997, SEC File No. 333-22941.
- (14) Filed as Exhibit 10.15 to the Company's Registration Statement on Form S-8 filed August 7, 1998, SEC File No. 333-60887.
- (15) Filed as Exhibit 10.2 to the Company's Registration Statement on Form S-4 filed March 11, 1997, SEC File No. 333-23075.
- (16) Filed as Exhibit 10.1 to the Company's Registration Statement on Form S-4 filed March 11, 1997, SEC File No. 333-23075.
- (17) Filed as Exhibit 10.3 to the Company's Annual Report on Form 10-K for the year ended June 30, 1997.
- (18) Filed as Exhibit 10.15 to the Company's Annual Report on Form 10-K for the year ended June 30, 1999.

(c) Reports on Form 8-K

None

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized on September 28, 2000.

KLA-Tencor Corporation

By: /s/ KENNETH LEVY

-----  
Kenneth Levy  
Chairman of the Board

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

SIGNATURE -----	TITLE -----	DATE ----
/s/ KENNETH LEVY ----- Kenneth Levy	Chairman of the Board and Director	September 28, 2000
/s/ KENNETH L. SCHROEDER ----- Kenneth L. Schroeder	President, Chief Executive Officer and Director (Principle Executive Officer)	September 28, 2000

----- /s/ JOHN H. KISPERT ----- John H. Kispert	Executive Vice President and Chief Financial Officer (Principal Accounting Officer)	September 28, 2000
----- /s/ EDWARD W. BARNHOLT ----- Edward W. Barnholt	Director	September 28, 2000
----- /s/ H. RAYMOND BINGHAM ----- H. Raymond Bingham	Director	September 28, 2000
----- /s/ ROBERT T. BOND ----- Robert T. Bond	Director	September 28, 2000
----- /s/ RICHARD J. ELKUS, Jr. ----- Richard J. Elkus, Jr.	Director	September 28, 2000
----- /s/ DEAN O. MORTON ----- Dean O. Morton	Director	September 28, 2000
----- /s/ JON D. TOMPKINS ----- Jon D. Tompkins	Director	September 28, 2000
----- /s/ LIDA URBANEK ----- Lida Urbaneck	Director	September 28, 2000

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Report of Independent Accountants on  
Financial Statement Schedules

To the Board of Directors  
of KLA-Tencor Corporation

Our audits of the consolidated financial statements referred to in our report dated July 24, 2000, except as to Note 9, which is as of August 15, 2000 appearing in this Annual Report on Form 10-K also included an audit of the financial statement schedule listed in Item 14(a)2 on this Form 10-K. In our opinion, this financial statement schedule presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements.

PRICEWATERHOUSECOOPERS LLP

San Jose, California  
July 24, 2000

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SCHEDULE II

Valuation and Qualifying Accounts

(in thousands)	Balance at Beginning of Period	Charged to Expense	Deductions	Balance At End of Period
Year Ended December 31, 1998:				
Allowance for Doubtful Accounts	\$ 2,980	\$ 13,577	\$ 8,295	\$ 8,262
Year Ended December 31, 1999:				
Allowance for Doubtful Accounts	\$ 8,262	\$ 19,271	\$ 10,895	\$ 16,638
Year Ended December 31, 2000:				
Allowance for Doubtful Accounts	\$ 16,638	\$ 13,731	\$ 15,580	\$ 14,789

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EXHIBITS

As required under Item 14, "Exhibits, Financial Statement Schedules and Reports on Form 8-K," the exhibits filed as part of this report are provided in this separate section. The exhibits included in this section are as follows:

Exhibit Number -----	Description -----
10.16	Livermore Land Purchase and Sale Agreement
21.1	List of Subsidiaries of KLA-Tencor Corporation
23.1	Consent of Independent Accountants
27.1	Financial Data Schedule

## PURCHASE AND SALE AGREEMENT

BY AND BETWEEN

SHEA CENTER LIVERMORE, LLC,  
A CALIFORNIA LIMITED LIABILITY COMPANY ("SELLER")

AND

KLA-TENCOR CORPORATION,  
A DELAWARE CORPORATION ("BUYER")

Dated: May 5, 2000

PURCHASE AND SALE AGREEMENT  
KLA-TENCOR

THIS PURCHASE AND SALE AGREEMENT (this "AGREEMENT") is entered into as of May 5, 2000 (the "EFFECTIVE DATE") by and between SHEA CENTER LIVERMORE, LLC, a California limited liability company ("SELLER") and KLA-TENCOR CORPORATION, a Delaware corporation ("BUYER") in the following factual context:

A. Seller is the owner of a business and commercial park in Livermore, California commonly referred to as Shea Center, comprising approximately 300 acres, as more particularly described in Exhibit A-1 complete with all privileges, rights, easements and appurtenances belonging to the real property, all minerals, water, and oil, gas and other hydrocarbon substances, and all development, air and water rights relating to the real property. The real property and other rights specified above are referred to herein as the "LAND".

B. The Land is subject to Tentative Parcel Map No. 7341 (the "TENTATIVE MAP") and Development Agreement No. 114-97 For Cayetano Corporate Campus, dated as of March 10, 1999, as amended, (the "DEVELOPMENT AGREEMENT").

C. Seller desires to sell, and Buyer desires to purchase, a portion of the Land (the "PROPERTY") consisting of approximately 31.5 acres of land, net of roads, as shown on Exhibit A-2, the exact size of which will be determined and agreed to by both parties during the Feasibility Period, on the terms and conditions specified below.

D. Buyer desires to have an option to purchase from Seller and Seller desires to grant Buyer an option to purchase the portion of the Land (the "OPTION PROPERTY") consisting of approximately 12.2 acres of land, net of roads, as shown on Exhibit A-3, the exact size of which will be determined and agreed to by both parties during the Feasibility Period, upon the terms and conditions specified below.

In this factual context and in consideration of the representations, warranties and covenants in this Agreement, the parties agree as follows.

## SECTION 1. PURCHASE AND SALE.

1.1 PROPERTY. Subject to the terms and conditions of this Agreement, Seller agrees to sell and Buyer agrees to purchase the Property.

1.2 TIF CREDITS AND OTHER IMPACT FEES. Seller has paid impact and other fees and has performed work entitling it to certain credits against future fees, including but not limited to traffic improvement fee credits, as more particularly described in Schedule 1 to this Agreement. Before committing to pay any impact or other fees in connection with obtaining entitlements or utility agreements for Buyer's anticipated development of the Property, Buyer shall purchase any of Seller's credits against future fees that it

could use against its impact or other fees. The purchase price for the credits shall be the price of the credits on the City of Livermore's then-existing fee schedule at the time purchased. In furtherance of this provision, Buyer shall provide Seller with ten (10) days written notice before applying for any building permits in connection with the development of the Property.

1.3 PURCHASE PRICE. The total purchase price for the Property (the "PURCHASE Price") shall be based on the size of the Property, as finally determined by the parties, at a rate of Ten and 96/100 Dollars (\$10.96) per square foot.

1.4 PAYMENT. The Purchase Price shall be paid as follows:

(a) Upon mutual execution of this Agreement, Buyer shall deposit into escrow the sum of Ten Thousand Dollars (\$10,000) in immediately available funds (the "DEPOSIT"). If Buyer approves the Feasibility Conditions described in Section 10.3 below within the Feasibility Period, Buyer shall deposit an additional Two Hundred Ninety Thousand Dollars (\$290,000) into escrow for a total Deposit of Three Hundred Thousand Dollars (\$300,000). The Deposit shall be refundable for failure of any condition to Closing, except failures resulting from Buyer's breach, together with interest actually earned while on deposit in escrow. The Deposit shall be credited against the Purchase Price, with interest actually earned while on deposit in escrow, at Closing.

(b) The balance of the Purchase Price (minus the Deposit) shall be paid to Seller in immediately available funds at Closing.

## SECTION 2 TITLE TO THE PROPERTY.

At the Closing, Seller shall convey to Buyer title to the real estate portion of the Property by duly executed and acknowledged grant deed in a standard title company form (the "GRANT DEED") together with a separate (non-recordable) transfer tax declaration (the "TRANSFER TAX DECLARATION"). Conclusive evidence of delivery of marketable and insurable fee simple title shall be the issuance by First American Title Insurance Company (the "TITLE COMPANY") of an ALTA extended coverage policy of title insurance (the "TITLE POLICY") in the amount of the purchase price for the Property insuring fee simple title to the real estate portion of the Property in Buyer, subject only to a lien for real property taxes and assessments not yet delinquent and such other exceptions as have been approved by Buyer (the "APPROVED EXCEPTIONS") and containing endorsements reasonably requested by Buyer. If, after the Closing, Buyer shall discover any defect in title not covered by the representations and warranties of Seller in Section 13.1, it shall look solely to the Title Policy for any recovery.

The Approved Exceptions shall include but not be limited to (a) the Repurchase Option and (b) covenants, conditions, restrictions, easements and similar rights created with the consent of Buyer, which consent Buyer shall not unreasonably withhold or delay. Buyer and Seller agree that it shall be reasonable for Buyer to withhold its consent if Buyer reasonably determines that such covenants, conditions, restrictions, easements or other rights will result in the occurrence of any of the following:

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(i) material interference with Buyer's intended development or use of the Property as contemplated pursuant to this Agreement, or (ii) any material impact upon the location of the buildings to be constructed on the Property by Buyer as shown on Buyer's site plan as approved by Seller (pursuant to Section 7.1) and the Planning Commission ("BUYER'S APPROVED SITE PLAN").

## SECTION 3. CONDITIONS TO CLOSING.

3.1 BUYER'S PURCHASE CONDITIONS. The following conditions are conditions precedent to Buyer's obligation to purchase the Property:

(a) The representations and warranties contained in Section 13.1 shall be true and correct when made and shall be true and correct as of the Closing, without any material adverse change, except for any material adverse change of which Seller has notified Buyer and Buyer has accepted in writing.

(b) Seller shall have performed all of its obligations under this Agreement.

(c) Seller shall have obtained all consents, approvals, authorizations and exemptions required to be obtained in order to consummate the transactions contemplated by this Agreement.

Conditions (a), (b) and (c) are for the benefit of and may be waived by Buyer. Upon the nonsatisfaction of conditions (a), (b) or (c), unless waived by Buyer, Buyer shall retain such remedies as it may have at law or in equity, provided, however that if any representation or warranty made by Seller in this Agreement becomes untrue as a result of occurrences beyond Seller's control, Seller shall not be in breach of the representation or warranty and Buyer's sole remedy shall be to waive the breach and close or to terminate this Agreement.

3.2 SELLER'S CONDITIONS. The following conditions are conditions precedent to Seller's obligation to sell the Property:

(a) The representations and warranties contained in Section 13.2 shall be true and correct when made and shall be true and correct as of the Closing, without any material adverse change, except for any material adverse change of which Buyer has notified Seller and Seller has accepted in writing.

(b) Buyer shall have performed all of its obligations under this Agreement.

Conditions (a) and (b) are for the benefit of and may be waived by Seller. Upon the nonsatisfaction of conditions (a) and (b), unless waived by Seller, Seller shall retain the remedies set forth in Section 14, provided, however that if any representation or warranty made by Buyer in this Agreement becomes untrue as a result of occurrences beyond Buyer's control, Buyer shall not be in breach of the representation or warranty and Seller's sole remedy shall be to waive the breach and close or to terminate this Agreement.

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3.3 JOINT CONDITIONS. The following conditions are conditions precedent to both Buyer's and Seller's obligations under this Agreement:

(a) The Title Company shall be irrevocably committed to issue the Title Policy described in Section 2.

(b) There shall not have occurred after the Effective Date any material adverse physical change in the Property from its condition as of the Effective Date.

(c) Seller shall have obtained final approvals by the City of Livermore (the "CITY") of, and thirty-five (35) days shall have passed after the date of filing by the City of its notice of determination with respect to, amendments to the Development Agreement, the Tentative Map, the Planned Unit Development #131 (the "PLANNED UNIT DEVELOPMENT"), and, if necessary, the Zoning Ordinance General Provision regarding the Airport Overlay ("ZONING ORDINANCE") to (1) increase the height of a two-story building to allow a building of 46 feet; (2) alter the Isabel Interchange Milestones to allow Buyer to construct 480,000 square feet on the Property at any time; (3) approve tentative map parcel lines and street configurations consistent with the Lot Line Adjustment; (4) approve the Lot Line Adjustment (including form of deed and plat map); and (5) approve the form of reciprocal easements to be recorded in connection with the Lot Line Adjustment deed, if required (collectively, the "ENTITLEMENTS").

(d) No order or injunction restraining or preventing the transactions contemplated by this Agreement or the development of the Property shall be in effect, and no action, suit or proceeding challenging the transactions contemplated by this Agreement or adversely affecting the development of the Property, including, but not limited to eminent domain proceedings, shall be pending before any court or government agency or be overtly threatened by any government agency.

Upon the nonsatisfaction of conditions (a) through (d), unless waived by Buyer and Seller in each of their sole discretion, the Agreement may be terminated by either party at any time after the date Escrow is otherwise



scheduled to close, in which event neither party shall have any further obligations under this Agreement except as otherwise specifically provided herein.

#### 3.4 TERMINATION FOR FAILURE OF CONDITION.

Upon termination of this Agreement Buyer shall deliver to Seller (i) copies of any studies, surveys and reports prepared for it by third parties relating to the Property (excluding privileged, proprietary, copyrighted or confidential information), without any warranty by Buyer as to utility or accuracy, but to Buyer's knowledge, complete, (ii) a quitclaim deed to Seller in recordable form releasing any interest of Buyer in the Property and (iii) all information which Seller furnished to, or permitted to be copied by, Buyer. After these deliveries and, unless the termination resulted from Buyer's breach, the return of the Deposit to Buyer, neither party shall have any further obligation to the other.

#### SECTION 4. COVENANTS.

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##### 4.1 SELLER'S COVENANTS. Seller covenants that:

Commencing on the Effective Date and continuing until the close of Escrow:

(a) Other than contracts entered into by Seller for completion of the Off-Site Improvements, Seller shall not enter into any agreement regarding the management, repair, improvement, or any other matter affecting the Property without the prior written consent of Buyer, which consent shall not be unreasonably withheld or delayed.

(b) Seller shall not permit any act of waste or act that would tend to diminish the value of the Property for any reason, except that caused by ordinary wear and tear.

(c) Seller will promptly after discovery notify Buyer in writing of any adverse material changes affecting the physical condition of the Property.

(d) With the exception of the Off-Site Improvements, Seller shall cause the Property to be maintained in substantially the same manner as it has been maintained prior to the Effective Date until the close of Escrow and shall not make any material changes to the Property or enter into any agreement affecting the Property without Buyer's prior consent, which consent shall not be unreasonably withheld or delayed.

(e) Seller shall comply with all terms and conditions of the Development Agreement and the Tentative Map generally relating to development of Shea Center other than those terms and conditions directly related to the development of the Property but not related to the completion of the Off-Site Improvements or payments to be made by Seller in connection with the Entitlements, which terms and conditions shall be the responsibility of Buyer.

(f) Seller agrees that during the Feasibility Period, it will meet and confer with Buyer prior to finalizing the Covenants, Conditions and Restrictions ("CC&RS") for Shea Center or any material aspect thereof, including without limitation the signage and landscape plans, design criteria, transportation and circulation elements, public use facilities, and so forth, and after the end of the Feasibility Period it will work with Buyer to minimize the impact of any material changes in the CC&Rs or design guidelines for Shea Center on Buyer's development of its campus within Shea Center.

##### 4.2 MUTUAL COVENANTS.

(a) Seller and Buyer each covenant to cooperate with the other in pursuing the matters set forth in this Section 4 and in Section 6 and in otherwise fulfilling the conditions to Closing. If after the Closing, Buyer seeks to subdivide the Property into more than four lots and/or the Option Property into more than two lots, Seller shall cooperate with Buyer in seeking approval of the additional subdivision at no material expense to Seller.

(b) Seller shall be entitled to encumber the Property at any time in the

future with assessment liens for the benefit of the Property. Buyer will not oppose the placement of assessment liens on the Property or the Option Property of up to \$2.50

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per square foot of land. Buyer shall be responsible for the timely payment of assessments on the Property up to \$2.50 per square foot. Seller shall prevent the placement of any assessment liens on the Property in excess of \$2.50 per square foot of land by paying the portion of the principal of the assessments such that the original principal balance does not exceed \$2.50 per square foot.

#### SECTION 5. CLOSING AND ESCROW.

5.1 CLOSING DATE. The "CLOSING" shall be consummated through Escrow No. 594192 (the "ESCROW") established at the offices of First American Title Company, 6665 Owens Drive, Pleasanton, California 94588, Attention: Diane Allen-Burton (the "ESCROW AGENT") upon the earlier of receipt by Buyer of a building or grading permit for the Property or August 21, 2000 (the "CLOSING DATE"); provided, however, that (i) Buyer may extend the Closing Date for up to three (3) periods of one month each for payment of one percent (1%) of the Purchase Price per month and (ii) Seller may extend the Closing for up to one hundred and eighty (180) days for delays in processing the Entitlements that are beyond Seller's control despite Seller's employment of commercially reasonable efforts to secure the Entitlements. The Purchase Price shall not be increased in connection with any extension of the Closing resulting from delays in processing the Entitlements. Subject to satisfaction or waiver by Buyer of the conditions to Closing set forth in Sections 3.1 and 3.3, any payments made by Buyer to extend the Closing shall be non-refundable and shall not be applied to the Purchase Price.

5.2 BUYER'S DEPOSITS INTO ESCROW. At or before Closing, Buyer shall execute, acknowledge, where appropriate, and deposit into Escrow

- (a) The Purchase Price (minus the Deposit);
- (b) Two signed counterparts of the Memorandum of Repurchase Option; and
- (c) Two signed counterparts of the Memorandum of Option.

5.3 SELLER'S DEPOSITS INTO ESCROW. At or before Closing, Seller shall execute, acknowledge, where appropriate, and deposit into Escrow:

- (a) The Grant Deed;
- (b) The Transfer Tax Declaration;
- (c) A FIRPTA Certificate;
- (d) A Withholding Affidavit;
- (e) Two signed counterparts of the Memorandum of Repurchase Option; and
- (f) Two signed counterparts of the Memorandum of Option.

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5.4 OTHER INSTRUMENTS. Seller and Buyer shall each deposit such other instruments as are reasonably required by the Title Company or otherwise required to close the Escrow and consummate the purchase and sale of the Property under this Agreement.

5.5 CLOSE OF ESCROW. At least five (5) business days before the anticipated Closing Date, the Escrow Agent shall prepare and submit to each of Seller and Buyer for their approval (not to be unreasonably withheld and to be deemed given unless Escrow Agent receives a written notice of disapproval prior to the Closing Date) a pro forma of the Title Policy and pro forma escrow settlement statements. As soon as (but not until) each of the following has occurred: (1) Buyer has delivered into Escrow (i) the documents described in

Section 5.2 and (ii) the Purchase Price (minus the Deposit) together with Buyer's share of closing costs; and (2) Seller has delivered into Escrow the documents described in Section 5.3, Escrow Agent shall date all undated documents as of the Closing Date and shall close Escrow by:

(a) Recording the Grant Deed (marked for return to Buyer) in the Official Records of the Alameda County Recorder's Office (which shall be deemed delivery to Buyer);

(b) Recording the Memorandum of Repurchase Option (marked for return to Seller) in the Official Records of the Alameda County Recorder's Office (which shall be deemed delivery to Seller);

(c) Recording the Memorandum of Option (marked for return to Buyer) in the Official Records of the Alameda County Recorder's Office (which shall be deemed delivery to Buyer);

(d) Issuing the Title Policy;

(e) Delivering to Seller:

(i) The portion of the Purchase Price remaining after deduction of (i) the amount of any net credits to Buyer resulting from the prorations pursuant to Section 5.6 hereof and (ii) Seller's share of closing costs;

(ii) Conformed copies of all recorded documents;

(iii) Copies of the other documents required of Buyer to be deposited in Escrow.

(e) Delivering to Buyer:

(i) Any funds remaining in Escrow after (i) disbursement to Seller of the Purchase Price and (ii) payment of all of the closing costs;

(ii) The FIRPTA Certificate executed by Seller;

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(iii) The Withholding Affidavit executed by Seller;

(iv) Conformed copies of all recorded documents;

(v) Copies of the other documents required of Seller to be deposited into Escrow.

5.6 PRORATIONS. General ad valorem real property taxes payable in the fiscal year in which the Closing Date occurs shall be prorated as of the Closing Date. If such taxes have not been determined as of the Closing Date, the proration shall be based upon the product of the taxes for the prior fiscal year and a factor of 1.02. If after Closing any supplemental real property taxes or any other additional real property taxes or assessments that are applicable to the period prior to the Closing are levied for any reason, including without limitation back assessments, escape assessments or any assessments under "Proposition 8", then Seller shall pay all such additional taxes and assessments, to the extent applicable to the period prior to the Closing. Any utility charges, annual permits and/or inspection fees (calculated on the basis of the period covered), and other expenses of the operation and maintenance of the real estate portion of the Property shall be prorated as of 12:01 a.m. on the Closing Date on the basis of a 365-day year. Seller and Buyer hereby agree that if any of the prorations cannot be calculated accurately on the Closing Date, then they shall be calculated as soon as reasonably possible after the Closing Date and any adjustments shall be paid within ten days of the subsequent proration together with interest at the rate of 10% per annum if not paid within ten days after demand. During the Feasibility Period, Seller shall provide to Buyer information reasonably requested by Buyer relating to utility charges, annual permits and/or inspection fees and other expenses of the operation and maintenance of the real estate portion of the Property to be prorated pursuant to this Section.

5.7 COSTS. Seller shall pay the cost of the premium for a standard CLTA

owner's policy of title insurance and transfer fees. The increased costs for an ALTA title insurance premium, for extended coverage or for any additional endorsements desired by Buyer shall be paid by Buyer. Buyer shall pay all survey costs in connection with obtaining an ALTA survey or extended coverage. Buyer shall pay all escrow and recording fees. Seller shall pay all documentary transfer taxes. Seller and Buyer shall each pay one-half of any local transfer taxes and of any other costs and charges of the Closing.

5.8 POSSESSION. Possession of the Property shall transfer to Buyer at the Closing.

#### SECTION 6. SELLER'S OBLIGATIONS.

6.1 LOT LINE ADJUSTMENT. Prior to Closing, Seller will reconfigure the existing legal parcels by means of a lot line adjustment (the "LOT LINE ADJUSTMENT") so that Seller may legally convey the Property to Buyer in the desired configuration prior to filing a Final Map. In connection with the recordation of the deed and plat map for the

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lot line adjustment, Seller will also record reciprocal easements with respect to all roads, road improvements, utilities, landscaping, signage, and other on- and off-site improvements contemplated by this Agreement. Buyer shall have the right to approve the Lot Line Adjustment and reciprocal easements, to the extent, and only to the extent, that they affect the Property, which approval shall not be unreasonably withheld or delayed and shall be given if the Lot Line Adjustment and reciprocal easements are substantially in compliance with the attached Exhibits A-2 and A-3.

6.2 OFF-SITE IMPROVEMENTS. Seller shall complete the off-site improvements listed on Schedule 2 to this Agreement (the "OFF-SITE IMPROVEMENTS") in the time frames set forth therein (subject to any delays beyond the reasonable control of Seller) resulting from the need to obtain approval of the City. Seller shall seek the City's approval of the Off-Site Improvements as soon as reasonably practicable. Buyer shall be entitled to review the plans for the Off-Site Improvements prior to the commencement of construction. The costs of the Off-Site Improvements as well as all other off-site improvements required by the City as a condition of the development of the Property shall be borne by Seller. The Off-Site Improvements will be completed in a good and workmanlike manner in compliance with all applicable governmental requirements. Seller shall provide Buyer with a commercially reasonable enforcement mechanism, the form of which shall be agreed upon by the parties during the Feasibility Period, to ensure that Seller's improvement obligations are timely completed.

6.3 AMENDMENT OF DEVELOPMENT AGREEMENT, TENTATIVE MAP, PLANNED DEVELOPMENT PERMIT AND ZONING ORDINANCE. Seller shall submit applications to the City for amendment of the Development Agreement, Tentative Map, Planned Unit Development and the Zoning Ordinance as necessary to obtain the Entitlements and shall complete all conditions of approval for such amendments.

#### SECTION 7 BUYER'S OBLIGATIONS.

7.1 APPROVAL OF SITE PLAN. Each time that Buyer prepares a revised site plan, it shall deliver the revised site plan to Seller for informal comments. Prior to submitting its final site plan to the Planning Commission for approval, Buyer shall submit its final site plan to Seller for approval, which approval shall not be unreasonably withheld. Seller shall review the site plan and respond as soon as is reasonably practicable, but no later than ten (10) days after receipt. If Seller has not approved or disapproved Buyer's site plan within ten (10) days after receipt, the site plan shall be deemed approved. If Seller disapproves Buyer's site plan, Seller shall specify the reasons for its disapproval in writing in reasonable detail and Buyer shall, within ten (10) days from the date of Seller's notice of disapproval, modify and resubmit its site plan to Seller. Buyer shall not submit its site plan to the Planning Commission until the site plan has been approved by Seller.

7.2 APPROVAL OF WORKING DRAWINGS. Concurrently with their submission to City for approval, Buyer shall deliver to Seller a set of working drawings, substantially in accordance with Buyer's Approved Site Plan (the "WORKING DRAWINGS") for Seller's review and approval, which approval shall not be

unreasonably withheld. The scope of

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Seller's review of the Working Drawings shall be limited to insuring consistency with the Buyer's Approved Site Plan. If Seller has not approved or disapproved the Working Drawings for the Property within ten (10) days after receipt, the Working Drawings shall be deemed approved. If Seller disapproves the Working Drawings, Seller shall specify in writing the reasons for such disapproval and Buyer shall, within ten (10) days from the date of Seller's notice of disapproval, modify and resubmit the Working Drawings to Seller. The revised Working Drawings shall be deemed approved by Seller, if they are not disapproved by Seller within ten (10) days after they are delivered to Seller. Buyer shall not commence construction on the Property until the Working Drawings have been approved by Seller. The improvements to be constructed by Buyer shown on Buyer's Approved Site Plan and Working Drawings, which improvements are limited to the shell of the building and do not include any tenant improvements, shall be referred to as the "APPROVED IMPROVEMENTS." Buyer covenants to build all Approved Improvements substantially in conformance with Buyer's Approved Site Plan and Working Drawings which have been approved by the City and Seller.

### 7.3 REPURCHASE OPTION.

(a) PROVISION OF NOTICE, GRANT OF OPTION. If Buyer has not commenced construction of Phase I by twenty-four (24) months after the Closing, Seller shall send a written notice to Buyer (the "CONSTRUCTION COMMENCEMENT NOTICE") requesting that Buyer confirm that it intends promptly to commence construction of Phase I. Buyer shall have thirty (30) days in which to respond to the Construction Commencement Notice. If Buyer intends to construct Phase I, Buyer shall so indicate in its response, shall within five (5) months provide Seller with a Construction Commencement Certificate and shall within eighteen (18) months thereafter provide Seller with a Construction Completion Certificate. If Buyer (i) fails to respond to the Construction Commencement Notice, (ii) responds to the Construction Commencement Notice but indicates that it does not intend promptly to commence construction of Phase I, or (iii) responds to the Construction Commencement Notice, provides Seller with the Construction Commencement Certificate within five (5) months of responding, but fails to submit a Construction Completion Notice within eighteen (18) months thereafter, Seller shall have the exclusive right and option to repurchase all or a portion of the Property ("REPURCHASE OPTION") pursuant to the terms and conditions specified below. If Seller exercises the Repurchase Option, Seller shall be entitled to repurchase not only Phase I but also all later Phases (together, the "REPURCHASE PROPERTY"). "Construction Commencement Certificate" shall mean a certificate from Buyer's engineer or architect certifying that the foundation, footings or slab for the required Approved Improvements for Phase I have been completed in accordance with Buyer's Approved Site Plan and Working Drawings. "Construction Completion Certificate" shall mean a certificate from Buyer's engineer or architect certifying that the required Approved Improvements for Phase I have been substantially completed in accordance with Buyer's Approved Site Plan and Working Drawings

(b) EXTENSION OF BUYER'S CONSTRUCTION COMMENCEMENT AND COMPLETION DEADLINES. If Buyer gives Seller written notice within ten (10) days after the date of first discovery of the occurrence of any delay with respect to its development of Phase I

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caused by any event of Force Majeure described below and specifies the reason for such delay, the commencement and completion deadlines for construction of Phase I, as applicable, shall be extended for a period equal to the time during which Buyer is delayed in satisfying Buyer's obligations to either commence or complete construction, as applicable, due to any of the following matters; provided, however, that neither the commencement nor the completion deadline shall be subject to extension for a period of more than one (1) year for Force Majeure reasons, or otherwise: (i) a judicial order or ruling, or action by the City or other governmental entity beyond the control of Buyer; (ii) a delay in action by the City or other governmental entity beyond that reasonably expected, which causes a delay, or denial in the (1) issuance of building, grading,

electrical, plumbing, water or sewer connection permit or other permits, (2) approval or plans, or (3) actual on-site construction, which adversely effects Buyer's day-to-day construction activities in a material way; or (iii) fire, earthquake, explosion, flood, hurricane, the elements, acts of God or the public enemy, war, invasion, insurrection, rebellion, riots, strikes, lockouts or delays occasioned by unanticipated geological soils conditions, and beyond the control of Buyer and which adversely affect Buyer's day-to-day on-site construction activities in a material way.

(c) REPURCHASE ESCROW. Within five (5) days after receipt by Buyer of Seller's notice of exercise of the Repurchase Option, Buyer and Seller shall enter into an escrow, with Escrow Agent ("REPURCHASE ESCROW") and shall execute any and all additional instructions requested by Escrow Agent consistent with the provisions of this Agreement. The Repurchase Escrow shall be deemed "opened" upon deposit with Escrow Agent of written instructions by Buyer and Seller to Escrow Agent respecting the repurchase of the Phase by Seller.

(i) CLOSE OF REPURCHASE ESCROW. The Repurchase Escrow shall close five (5) days after opening or as soon thereafter as is reasonably possible.

(ii) REPURCHASE PRICE. If Seller is repurchasing under paragraph (i) or (ii) of Section 7.3(a), the repurchase price for the Property shall be the repurchase price for undeveloped land set forth in Section 11.2(a). If Seller is repurchasing under paragraph (iii) of Section 7.3(a), the repurchase price for the Property shall be the repurchase price for undeveloped land set forth in Section 11.2(a) less the cost of demolition of any partial improvements constructed on the Property, provided, however, that if Seller elects to complete such improvements, the repurchase price for the Property shall be the repurchase price for undeveloped land set forth in Section 11.2(a) plus the amount of any capital expenditures made by Buyer with respect to the partial improvements. The repurchase price shall be payable in cash at the close of the Repurchase Escrow.

(iii) TITLE. Title to Repurchase Property shall be conveyed to Seller in the same condition as when conveyed by Seller to Buyer with the exception of nondelinquent real property taxes and assessments which shall be prorated at the close of the Repurchase Escrow. However, Seller may elect to assume any monetary encumbrance against the Repurchase Property or to take title to the Repurchase Property subject to such encumbrance by written notice to Buyer, in which case Seller

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shall be entitled to a credit against the repurchase price for the Repurchase Property in an amount equal to the unpaid principal balance, together with accrued and unpaid interest, under the indebtedness secured by such encumbrance.

(iv) TITLE INSURANCE. The Repurchase Escrow shall not close until Escrow Agent is in a position to issue to Seller a CLTA standard coverage policy of title insurance with liability equal to the repurchase price, insuring title to the Repurchase Property vested in Seller as provided above.

(v) MISCELLANEOUS. All costs incurred in connection with the Repurchase Escrow, including without limitation escrow, closing and title costs shall be paid by Buyer.

(d) MEMORANDUM OF REPURCHASE OPTION. Buyer and Seller shall execute and cause a Memorandum of Repurchase Option in the form attached as Exhibit B ("MEMORANDUM OF REPURCHASE OPTION") for the Repurchase Property to be recorded concurrently with the Close of Escrow.

(e) RELEASE OF OPTION RIGHTS. Upon substantial completion of the Approved Improvements for Phase I, Seller shall, at Buyer's request, if Seller has not previously exercised the Repurchase Option, deliver to Buyer a duly executed and acknowledged quitclaim of Seller's Repurchase Option rights.

SECTION 8. PHASES OF CONSTRUCTION; FAR ALLOCATION.

Buyer intends to first construct 240,000 total square feet of floor area in two buildings ("PHASE I"), and subsequently to construct another 240,000 total square feet of floor area in two buildings ("PHASE II"). If Buyer

exercises its Option to purchase the Option Property, Buyer intends to construct yet another 240,000 total square feet of floor area in two buildings ("PHASE III"). Phases I and II will have an estimated floor area ratio("FAR") of 0.35 (480,000/1,372,140), and Phase III has an estimated FAR of 0.45 (240,000/531,432), subject to modification based on the final approved lot lines for each parcel. The maximum allowed FAR for the entire 130-acre park is 0.35. Seller will permit Buyer to develop Phases I and II with a maximum FAR of 0.35 and Phase III with a maximum FAR of 0.45. Any allocated yet unused FAR on Phases I and II may be used by Buyer to increase the total FAR on Phase III or may be reserved by Buyer for future expansion on any of its Phases; provided, however, that the total FAR for all three Phases shall will not exceed the total FAR of approximately 0.378. No FAR shall be used for retail improvements available to the general public.

#### SECTION 9. INVESTIGATION AND APPROVAL OF PROPERTY.

9.1 FEASIBILITY PERIOD. Buyer shall have until the later of (i) two (2) days after a hearing by the Planning Commission is held to consider Buyer's Application for Site Plan Approval, but not later than July 20, 2000 or (ii) June 20, 2000 (the "FEASIBILITY PERIOD") to either approve or disapprove the Feasibility Conditions. If disapproval is not received in writing prior to the expiration of the Feasibility Period, Buyer will be deemed to have approved the Feasibility Conditions.

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9.2 RIGHT TO INSPECT. During the Feasibility Period, Buyer shall have the right to enter upon the Property and conduct, at its sole expense, such surveys, studies and investigations (collectively "INVESTIGATIONS") as Buyer deems necessary. If Buyer excavates or otherwise disturbs the condition of the Property and, if Escrow fails to close for any reason, Buyer shall restore the Property to the condition it would have been in absent such excavations or disturbances by Buyer. Prior to performing any of the Investigations, Buyer shall obtain all permits and authorizations and shall pay all applicable fees required by any public body or agency in connection with the Investigations. Buyer shall indemnify, defend and hold Seller and the Property, harmless from all damage, loss or liability, including, without limitation, attorneys' fees and costs of court, mechanics' liens or claims or assertions of claims arising out of or in connection with the Investigations, with the exception of any reduction in the value of the Property resulting from information discovered during the Investigations.

9.3 FEASIBILITY CONDITIONS. The following conditions (the "FEASIBILITY CONDITIONS") shall be approved or disapproved by Buyer prior to the expiration of the Feasibility Period:

(a) All matters relating to title, together with all municipal and other legal requirements such as taxes, assessments, zoning, use permit requirements and building codes;

(b) The physical condition of the real estate portion of the Property, including the gross and net square footage of the land, the soils and the presence or absence of hazardous materials on, under or in the vicinity of the Property and all other physical and functional aspects of the Property;

(c) All easements and access rights;

(d) The economics and potential use and development; and

(e) Buyer's ability to finance.

Buyer specifically agrees that it is relying solely on its own examination and inspection of the Property and all related matters, as set forth in this Section 9 and, except as otherwise expressly provided in this Agreement, is not relying upon any warranties or representations, express or implied, of Seller or other information from Seller. Buyer agrees to take the Property "AS IS" in its condition as of Closing and upon Closing Buyer shall have approved all aspects of the Property without limitation.

#### SECTION 10 OPTION.

10.1 GRANT OF OPTION. So long as Buyer is not in default under any

provision of this Agreement, Seller grants Buyer an option (the "OPTION") to purchase the Option Property subject to the terms and conditions of this Agreement.

10.2 OPTION PERIOD. By December 1, 2001 (the "OPTION TRIGGER DATE"), Buyer shall provide Seller with written notice of its intent to exercise the Option. If Buyer

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does not provide Seller with its notice of exercise by the Option Trigger Date, the Option shall lapse.

10.3 PURCHASE PRICE. The purchase price for the Option Property shall be based on the size of the Option Property, as finally determined by the parties, at a rate of Ten and 96/100 Dollars (\$10.96) per square foot; provided, however, that the purchase price for the Option Property shall increase by .0333% (non-compounded) each day commencing on the Option Trigger Date.

10.4 PAYMENT.

(a) Within five (5) business days after Buyer delivers its notice of exercise to Seller, Buyer shall deposit One Hundred Fifty Thousand Dollars (\$150,000) into escrow (the "OPTION DEPOSIT"). The Option Deposit shall be refundable for failure of any condition to Closing with respect to the Option Property, except failures resulting from Buyer's breach, together with interest actually earned while on deposit in escrow, and shall be credited against the purchase price for the Option Property along with interest actually earned while deposited in escrow.

(b) The balance of the purchase price for the Option Property shall be paid to Seller in immediately available funds at the closing of the purchase and sale of the Option Property.

10.5 CLOSING. Subject to the provisions of this Section 10.5, the closing of the purchase and sale of the Option Property shall take place on or before February 21, 2002. Seller warrants that it shall restrict other development within Shea Center and/or meet the occupancy milestones under the Development Agreement by means of completion of the obligations set forth in the "Limitations on Occupancy" provisions set forth in Exhibit 6.2 to the Development Agreement, bonding or other means satisfactory to governmental agencies with jurisdiction, such that by February 21, 2003, Buyer will be legally entitled to occupy up to 240,000 square feet of building area on the Option Property. Prior to the closing of the purchase and sale of the Option Property, Seller shall provide Buyer will confirmation that it will meet the foregoing obligation.

10.6 OTHER PURCHASE TERMS. Except for those terms and provisions specifically provided in this Section 10, the terms and conditions set forth in this Agreement for the purchase of the Property shall also govern the purchase of the Option Property.

10.7 MEMORANDUM OF OPTION. Buyer and Seller shall execute and cause a Memorandum of Option in the form attached as Exhibit C (the "MEMORANDUM OF OPTION") to be recorded concurrently with the Close of Escrow.

SECTION 11. RIGHT OF FIRST OFFER.

11.1 OFFER NOTICE. If at any time within five (5) years after the Closing, Buyer desires to sell all or any portion of the Property or, if at any time within five (5) years

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after the closing of the purchase of the Option Property, Buyer wishes to sell all or any portion of the Option Property (the portions of the Property and/or the Option Property which Buyer desires to sell shall be referred to as the "OFFER PROPERTY") then, before offering the Offer Property to a third party, Buyer shall first offer Seller the opportunity to acquire the Offer Property. Buyer shall provide Seller with a written notice of the economic terms and



conditions upon which it is willing to transfer the Offer Property (the "OFFER NOTICE"). Seller shall have a period of thirty (30) days in which to notify Buyer of its agreement to acquire the Offer Property.

#### 11.2 REPURCHASE PRICE.

(a) If at the time of the Offer Notice no buildings have yet been constructed on the Offer Property, the repurchase price for the Offer Property shall be the portion of the Purchase Price attributable to the Offer Property plus the amount of any capital expenditures made by Buyer with respect to the Offer Property (together, the "BUYER'S CAPITAL COSTS") plus fifty percent (50%) of the difference between (i) Buyer's Capital Costs and (ii) the fair market value of the Offer Property at the time of the repurchase (the "MARKET VALUE"). If Buyer and Seller are unable to agree upon the Market Value of the Offer Property, at 10:00 a.m. on the 10th day after Seller notifies Buyer of its intent to exercise the Repurchase Option, Buyer and Seller shall each simultaneously exchange with the other a sealed envelope with a written determination of the fair market value of the Offer Property. If only one valuation is submitted within the requisite time period, the fair market value contained in that valuation shall be the Market Value and shall be final and binding on the parties. If both valuations are timely submitted and they differ by less than 5% of the lower of the two, the average of the two valuations shall be the Market Value and shall be final and binding on the parties. If the two valuations differ by more than 5% of the lower of the two, the parties shall select a neutral appraiser (the "REFEREE") within 20 days thereafter. The parties shall deliver copies of both valuations to the Referee along with each parties comparables and other data providing the basis for its valuation, and the Referee shall select, within 5 days after receipt, the valuation which he or she believes most accurately represents the fair market value of the Offer Property and the selected valuation shall be the Market Value and shall be final and binding on the parties. The Referee appointed pursuant to this Section shall be a member of the American Institute of Appraisers with not less than 10 years experience appraising similar properties. The cost of the Referee shall be borne equally by the parties.

(b) If at the time of the Offer Notice improvements have been constructed on the Offer Property, the repurchase price shall be the purchase price stated in the Offer Notice.

11.3 ACCEPTANCE OF OFFER NOTICE, SALE TO THIRD PARTY. If Seller notifies Buyer of its acceptance of the Offer Notice, then Seller shall have ninety (90) days from the date of the acceptance to close escrow. If Seller has not notified Buyer of its acceptance within the thirty-day period, then Buyer may, for a period of one hundred eighty (180) days, enter into a binding agreement to transfer the Offer Property to the third party or its assignee and shall not be required to re-offer the Offer Property to Seller unless the net present value of all of the economic terms to Buyer in the proposed transaction is less than ninety-five percent (95%) of the net present value of

the economic terms to Buyer in the transaction offered to Seller. If the Offer Property is not subject to a binding agreement of sale or transfer within the two hundred and ten (210) days from the Offer Notice, it shall again be subject to the provisions of this Section. The net present value shall be calculated on a monthly basis using a discount rate of nine percent (9%) per annum. All of the non-economic terms not stated in the Offer Notice shall be those customary for a similar type of property transaction, with any disagreement over the non-economic terms settled by arbitration before a single arbitrator in accordance with the Arbitration procedures in the California Code of Civil Procedure.

11.4 EXCEPTED TRANSACTIONS. Neither (i) the transfer of the Offer Property to any individual, corporation, partnership, trust, limited liability company or unincorporated organization or governmental entity either (A) controlling, controlled by or under common control with Buyer, such control being exercised through the ownership or control, directly or indirectly, of more than 50% of the voting power of the shares entitled to vote for the election of directors or other governing authority, as of the date of this Agreement or hereafter or (B) resulting from a merger or consolidation involving substantially all of Buyer's business (each, an "AFFILIATE") nor (ii) a sale/lease-back transaction in which Buyer remains as a tenant on the Offer

Property for not less than seven (7) years, shall trigger Seller's repurchase rights under the provisions of this Section 11.

SECTION 12. LOSS BY CASUALTY; CONDEMNATION.

12.1 RISK OF LOSS. In the event of any casualty (including for example and not by way of limitation landslide or other earth movement) which would cause the loss of any of the developable portions of the real estate portion of Property, the Purchase Price shall be reduced proportionately based on the reduction in square footage of building area that can be constructed on the Property. In the event of any casualty which would cause the loss of 10% or more of the developable portions of the real estate portion of Property, Buyer shall have the right, in its sole discretion, to terminate this Agreement by written notice to Seller within ten days after the casualty, in which event neither party shall have any further obligations under this Agreement except as otherwise specifically provided herein.

12.2 CONDEMNATION. If, prior to the Closing Date, any proceedings are commenced to take all or any part of the real estate portion of the Property by eminent domain, or any individual or entity with the power of eminent domain threatens to take all or any part of the real estate portion of the Property which would result in the loss of 10% or more of the developable portions of the real estate portion of the Property, Buyer shall have the right, in its sole discretion, to terminate this Agreement by written notice to Seller within ten days after delivery of Seller's notice of any pending or threatened condemnation proceeding, in which event neither party shall have any further obligations under this Agreement except as otherwise specifically provided herein. If Buyer does not elect to terminate, Buyer shall have the right to participate in the proceedings in order to attempt to maximize the amount of the award, minimize the adverse impact of the taking on the Property and otherwise protect its interests. If the

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taking is completed before Closing, the real estate portion of the Property taken shall be excluded from the Property and the Purchase Price shall be adjusted accordingly. If the taking is not completed until after Closing, the Purchase Price shall be calculated including the real estate portion of the Property to be taken and Seller shall deliver to Buyer at Closing all amounts received on account of the award, together with an assignment of all of Seller's right, title and interest in and to the award for the taking. Seller shall notify Buyer in writing promptly upon receipt of notice, and in any event prior to Closing, of any pending or threatened condemnation proceeding against all or any part of the real estate portion of the Property. Seller shall request that the condemning authority allocate any award between the real estate portion of the Property and any other property which is the subject of the condemnation.

SECTION 13. REPRESENTATIONS AND WARRANTIES.

13.1 SELLER'S REPRESENTATIONS AND WARRANTIES. Seller makes the following representations, warranties and covenants to Buyer as of the Effective Date. For all purposes of this Agreement, including Seller's representations and warranties contained in this Section, the phrase "TO THE BEST OF SELLER'S KNOWLEDGE" shall mean the current actual knowledge of Robert M. Burke, Kevin Peters, or Jeff Melrose, who are the individuals most knowledgeable about the Property, without undertaking any independent investigation. The individuals who serve as the measure of knowledge shall have no personal liability.

(a) Seller is a limited liability company duly organized, validly existing and in good standing in the State of California. At the time of their execution and delivery, this Agreement and all other documents executed by Seller and delivered by Seller to Buyer shall be: (i) duly authorized, executed and delivered by Seller; (ii) legal, valid and binding obligations of Seller; and (iii) enforceable in accordance with their respective terms.

(b) Execution of this Agreement and all related documents, and the full and complete performance by Seller of all of its obligations under this Agreement and all related documents, will not violate, result in any breach of, constitute (with or without the giving of notice or the passage of time or both) a default under or trigger the acceleration of any agreement, bond, indenture, mortgage, deed of trust, bank, loan or credit agreement or other instrument to which Seller is a party or by which Seller is bound. Seller is not in default

under any note, evidence of indebtedness, lease, contract, license, undertaking or other agreement such that the liability thereunder might impair Seller's ability to perform its obligations under this Agreement.

(c) With the exception of the Entitlements, no consent from, or notice to, any federal, state or local government, bureau, department, court commission or agency, or any other person or entity, whether or not governmental in character, is required to permit Seller to execute, deliver and perform all its obligations under this Agreement.

(d) Seller has delivered to Buyer all surveys, soils and environmental reports, maps, permits, approvals, agreements, assessments, improvement plans, leases,

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covenants, conditions and restrictions and other material documents that to the best of Seller's knowledge are relevant to the development and use of the Property that are in the Seller's possession or under its control.

(e) To the best of Seller's knowledge, there is no pending litigation, eminent domain proceedings, notices from any governmental or quasi-governmental agencies or other notices of claims of any kind that would materially adversely affect Buyer's ability to develop the Property in accordance with the Development Agreement.

(f) To the best of Seller's knowledge:

(i) No Hazardous Materials are being or have been produced or disposed of on the Property or (with the exception of motor vehicle fuels stored in construction vehicle fuel tanks or in temporary aboveground tanks for refueling of construction vehicles) stored on or below the surface of the Property by Seller during Seller's ownership thereof, and Seller has no actual knowledge that any Hazardous Materials have been produced or disposed of on the Property or (with the exception of motor vehicle fuels stored in construction vehicle fuel tanks or in temporary aboveground tanks for refueling of construction vehicles) stored on or below the surface of the Property by any other person or entity.

(ii) Seller has received no notice from and, to the best of Seller's knowledge, there is not currently pending any proceeding or investigation by any governmental authority concerning the existence of Hazardous Materials on the Property.

For purposes of this Agreement, "HAZARDOUS MATERIALS" or toxic substances shall mean substances defined as "hazardous substances "hazardous material," or "toxic substances" in the Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended, 42 U.S.C.ss.ss.9601 et seq.; the Hazardous Materials Transportation Act, 49 U.S.C.ss.ss. 1801 et seq.; the Resource Conservation and Recovery Act, 42 U.S.C.ss.ss. 6901 et seq.; and those substances defined as "hazardous waste" in Section 25117 of the California Health and Safety Code or, as "hazardous substances" in Section 25316 of the California Health and Safety Code; and in the regulations adopted pursuant to said laws.

(g) To the best of Seller's knowledge, there is no pending or threatened litigation against Seller or the Property which would materially and adversely impact Buyer's contemplated use and development of the Property.

(h) To the best of Seller's knowledge, the grading of the Property and the completion of any Off-Site Improvements performed to date were performed in a good and workmanlike manner in accordance with all applicable plans and specifications.

(i) The representations and warranties made by Seller contain no untrue statement of material fact and do not omit any material fact necessary to make the statements contained therein not misleading.

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13.2 BUYER'S REPRESENTATIONS AND WARRANTIES. Buyer makes the following representations, warranties and covenants to Seller as of the Effective Date:

(a) Buyer is a corporation duly organized and validly existing under the laws of the State of Delaware and qualified to do business in the State of California. At the time of their execution and delivery, this Agreement and all other documents executed by Buyer and delivered by Buyer to Seller shall be: (i) duly authorized, executed and delivered by Buyer; (ii) legal, valid and binding obligations of Buyer; and (iii) enforceable in accordance with their respective terms.

(b) Execution of this Agreement and all related documents, and the full and complete performance by Buyer of all of its obligations under this Agreement and all related documents, will not violate, result in any breach of, constitute (with or without the giving of notice or the passage of time or both) a default under or trigger the acceleration of any agreement, bond, indenture, mortgage, deed of trust, bank, loan or credit agreement or other instrument to which Buyer is a party or by which Buyer is bound. Buyer is not in default under any note, evidence of indebtedness, lease, contract, license, undertaking or other agreement such that the liability thereunder might impair Buyer's ability to perform its obligations under this Agreement.

(c) With the exception of the Entitlements, no consent from, or notice to, any federal, state or local government, bureau, department, court commission or agency, or any other person or entity, whether or not governmental in character, is required to permit Buyer to execute, deliver and perform all its obligations under this Agreement.

(d) The representations and warranties made by Buyer contain no untrue statement of material fact and do not omit any material fact necessary to make the statements contained therein not misleading.

SECTION 14 LIQUIDATED DAMAGES.

If this Agreement is terminated other than as a result of a default by Buyer, the Deposit (or, if the default relates to the purchase of the Option Property, the Option Deposit) plus interest actually earned while on deposit in escrow shall be returned to Buyer. If this Agreement is terminated as a result of a default by Buyer under this Agreement, the Deposit (or, if the default relates to the purchase of the Option Property, the Option Deposit) and interest actually earned while on deposit in escrow shall be retained by Seller as liquidated damages. THE PARTIES AGREE THAT THE SELLER'S ACTUAL DAMAGES IN THE EVENT OF A FAILURE OF BUYER TO CLOSE THE PURCHASE OF THE PROPERTY (OR THE OPTION PROPERTY, IF APPLICABLE) WOULD BE EXTREMELY DIFFICULT OR IMPRACTICABLE TO DETERMINE. THEREFORE, BY PLACING THEIR INITIALS BELOW, THE PARTIES ACKNOWLEDGE THAT THE DEPOSIT (OR, IF THE DEFAULT RELATES TO THE PURCHASE OF THE OPTION PROPERTY, THE OPTION DEPOSIT) PLUS INTEREST ACTUALLY EARNED WHILE ON DEPOSIT IN ESCROW HAS BEEN AGREED UPON, AFTER NEGOTIATION, AS THE PARTIES' REASONABLE ESTIMATE OF SELLER'S DAMAGES AND AS SELLER'S EXCLUSIVE REMEDY

AGAINST BUYER, AT LAW OR IN EQUITY, IN THE EVENT THE SALE OF THE PROPERTY IS NOT CONSUMMATED AS A RESULT OF A DEFAULT UNDER THIS AGREEMENT ON THE PART OF BUYER.

SELLER'S INITIALS: \_\_\_\_\_ BUYER'S INITIALS: \_\_\_\_\_

SECTION 15. MISCELLANEOUS.

15.1 ATTORNEYS' FEES. If any legal action or other proceeding is commenced to enforce or interpret any provision of, or otherwise relating to, this Agreement, the losing party shall pay the prevailing party's actual expenses incurred in the investigation of any claim leading to the proceeding, preparation for and participation in the proceeding, any appeal or other post judgment motion, and any action to enforce or collect the judgment including contempt, garnishment, levy, discovery and bankruptcy. For this purpose "expenses" include, without limitation, court or other proceeding costs and experts' and attorneys' fees and their expenses. The phrase "prevailing party" shall mean the party who is determined in the proceeding to have prevailed or who prevails by dismissal, default or otherwise.

15.2 CONSTRUCTION OF AGREEMENT. The parties mutually acknowledge that they and their attorneys have participated in the preparation and negotiation of this Agreement. In cases of uncertainty this Agreement shall be construed without regard to which of the parties caused the uncertainty to exist.

15.3 FURTHER ASSURANCES. Each party, at any time before or after the Closing, shall at its own expense execute, acknowledge and deliver any additional deeds, assignments, conveyances and other assurances, documents and instruments reasonably requested by the other party, and shall take any other action consistent with the terms of this Agreement that may reasonably be requested by such other party, for the purpose of confirming and effectuating any of the transactions contemplated by this Agreement.

15.4 INTEGRATION. This Agreement sets forth the entire understanding of the parties relating to the transactions they contemplate, and supersedes all prior understandings relating to them, whether written or oral. There are no obligations, commitments, representations or warranties relating to them except those expressly set forth in this Agreement.

15.5 NOTICES. All notices, consents, requests, demands or other communications to or upon the respective parties shall be in writing and shall be effective for all purposes upon receipt on any day other than a Saturday, Sunday, or federal or state legal holiday (a "BUSINESS DAY") before 5:00 PM local time and on the next business day if received after 5:00 PM or on other than a business day, including without limitation, in the case of (i) personal delivery, (ii) delivery by messenger, express or air courier or similar courier, (iii) delivery by United States first class certified or registered mail, postage prepaid, and (iv) transmittal by electronically confirmed telecopier or facsimile, addressed as follows:

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To Seller: SHEA CENTER LIVERMORE, LLC  
c/o SHEA HOMES LIMITED PARTNERSHIP  
2155 Las Positas Ct., Suite. U  
Livermore, CA 94550  
Attn: Robert M. Burke  
Telephone: 925-373-2235  
Facsimile: 925-373-2555

With a copy to: McCUTCHEN, DOYLE, BROWN & ENERSEN, LLP  
3150 Porter Drive  
Palo Alto, CA 94304-1212  
Attention: Edward S. Merrill, Esq.  
Telephone: 650-849-4876  
Facsimile: 650-849-4800

To Buyer: KLA-TENCOR CORPORATION  
160 Rio Robles  
San Jose, CA 95134-1809  
Attn: Richard H. Austin  
Telephone: 408-875-5778  
Facsimile: 408-875-7578

With a copy to: SILICON VALLEY LAW GROUP  
132 N. Third Street, Suite 900  
San Jose, CA 95112  
Attention: Lucy Lofrumento  
Telephone: 408-286-6100  
Facsimile: 408-286-1400

Either party may change its address by written notice to the other in the manner set forth above. Receipt of communications by United States first class or registered mail shall be sufficiently evidenced by return receipt. Receipt of communication by facsimile shall be sufficiently evidenced by a machine generated confirmation of transmission without notation of error. In the case of illegible or otherwise unreadable facsimile transmissions, the receiving party shall promptly notify the transmitting party of any transmission problem and the transmitting party shall promptly resend any affected pages.

15.6 RELATIONSHIP. The relationship of the parties to this Agreement is determined solely by the provisions of this Agreement. The parties do not intend

to create any agency, partnership, joint venture, trust or other relationship with duties or incidents different from those of parties to an arm's-length contract.

15.7 SEVERABILITY. The provisions of this Agreement are intended to be severable and enforced to the maximum extent permitted by law. If for any reason any provision of this Agreement shall be held invalid, illegal or unenforceable in whole or in part in any jurisdiction, then that provision shall be ineffective only to the extent of the

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invalidity, illegality or unenforceability and in that jurisdiction only, without in any manner affecting the validity, legality or enforceability of the unaffected portion and the remaining provisions in that jurisdiction or any provision of the Agreement in any other jurisdiction. The unaffected portion and provisions of the Agreement will be enforced to the maximum extent permitted by law.

15.8 ASSIGNABILITY. Neither Buyer nor Seller shall assign its rights or delegate its duties under this Agreement without the prior written consent of the other party, which consent shall not be unreasonably withheld, other than to its Affiliates.

15.9 THIRD PARTIES. Nothing in this Agreement shall be construed to give any person other than the express parties to this Agreement any benefits, rights or remedies.

15.10 TIME OF THE ESSENCE. Time is of the essence in the performance of each party's respective obligations under this Agreement, and no notice of a party's intent to require strict compliance with the deadlines set forth in this Agreement is required.

15.11 TRANSACTION EXPENSES. Whether or not the transactions contemplated by this Agreement are consummated, each party shall pay its own fees and expenses incident to the negotiation, preparation, execution, authorization (including any necessary meetings or actions) or delivery of this Agreement and in consummating the transactions contemplated by this Agreement, including, without limitation, the fees and expenses of its attorneys, accountants and other advisors.

15.12 WAIVER, MODIFICATION AND AMENDMENT. No amendment of, supplement to or waiver of any obligations under this Agreement will be enforceable or admissible unless set forth in a writing signed by the party against which enforcement or admission is sought. No delay or failure to require performance of any provision of this Agreement shall constitute a waiver of that provision as to that or any other instance. Any waiver granted shall apply solely to the specific instance expressly stated.

15.13 BROKERS' FEES. Seller shall pay a brokers commission to each of The Staubach Company (Buyer's Broker) and Cornish & Carey (Seller's Broker) in the amount of two and a half percent (2 1/2%) of the Purchase Price upon and only upon the Closing Date. If Buyer exercises its Option to purchase the Option Property, Seller shall also pay a commission equal to two and a half percent (2 1/2%) of the Option Price to each of The Staubach Company and Cornish & Carey upon and only upon close of escrow for the Option Property.

15.14 SURVIVAL. Any claims for breaches as of the Closing Date of any representations, warranties or covenants contained in this Agreement must be brought within one (1) year of the Closing Date. The covenants of this Agreement contemplating performance after the Closing shall survive until fulfilled.

15.15 COUNTERPARTS. This Agreement may be executed in any number of counterparts and each counterpart shall be deemed to be an original document. All executed counterparts together shall constitute one and the same document, and any

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counterpart signature pages may be detached and assembled to form a single original document. A facsimile of a counterpart signature page shall be considered the equivalent of an ink original for all purposes.

SELLER:

SHEA CENTER LIVERMORE, LLC, a California limited liability company

By: J.F. Shea Co., Inc., a Nevada corporation

By \_\_\_\_\_  
Print Name \_\_\_\_\_  
Title \_\_\_\_\_

BUYER:

KLA-TENCOR CORPORATION, a Delaware corporation

By \_\_\_\_\_  
Print Name \_\_\_\_\_  
Title \_\_\_\_\_

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DEFINED TERMS

TERM	DEFINED IN
Affiliate	Section 11.4
Agreement	Preamble
Approved Exceptions	Section 2
Approved Improvements	Section 7.2
business day	Section 15.5
Buyer	Preamble
Buyer's Approved Site Plan	Section 2
Buyer's Capital Costs	Section 11.2(a)
CC&Rs	Section 4.1(f)
Capital Expenditures	Section 11.2
City	Section 3.3(c)
Closing	Section 5.1
Closing Date	Section 5.1
Construction Commencement Certificate	Section 7.3(a)
Construction Commencement Notice	Section 7.3(a)
Construction Completion Certificate	Section 7.3(a)
Deposit	Section 1.4(a)
Development Agreement	Recital B
Effective Date	Preamble
Entitlements	Section 3.3(c)
Escrow	Section 5.1
Escrow Agent	Section 5.1
FAR	Section 8
Feasibility Conditions	Section 9.3
Feasibility Period	Section 9.1
Grant Deed	Section 2
Hazardous Materials	Section 13.1(f)
Investigations	Section 9.2
Land	Recital A
Lot Line Adjustment	Section 6.1
Market Value	Section 11.2(a)
Memorandum of Option	Section 10.7
Memorandum of Repurchase Option	Section 7.3(d)
Off-Site Improvements	Section 6.2

Offer Notice	Section 11.1
Offer Property	Section 11.1
Option	Section 10.1
Option Deposit	Section 10.4
Option Property	Recital D
Option Trigger Date	Section 10.2
Phase I	Section 8
Phase II	Section 8
Phase III	Section 8

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Planned Unit Development	Section 3.3(c)
Preliminary Title Report	Section 2.1
Property	Recital C
Purchase Price	Section 1.3
Referee	Section 11.2(a)
Repurchase Escrow	Section 7.3(c)
Repurchase Option	Section 7.3(a)
Repurchase Property	Section 7.3(a)
Seller	Preamble
Tentative Map	Recital B
Title Company	Section 2
Title Policy	Section 2
Transfer Tax Declaration	Section 2
Working Drawings	Section 7.2
Zoning Ordinance	Section 3.3(c)

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EXHIBIT B

MEMORANDUM OF REPURCHASE OPTION

See attached.

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EXHIBIT C

MEMORANDUM OF OPTION

See attached.

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SCHEDULE 1

TIF CREDITS AND OTHER IMPACT FEES.

Credit Type

Currently Held

Anticipated During  
Project Lifetime



TIF Credits

\$1,132,928

\$36,798,416

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SCHEDULE 2

OFF-SITE IMPROVEMENTS CONSTRUCTION SCHEDULE

See attached.

KLA-Tencor Subsidiaries  
-----

Name -----	State or Other Jurisdiction of Incorporation -----
DOMESTIC SUBSIDIARIES	
International Sales & Business, Inc.	California
KLA-Tencor Building Corporation	California
KLA-Tencor DISC Corporation	California
KLA-Tencor International Corporation	California
KLA-Tencor Klinnik Corporation	California
KLA-Tencor Technologies Corporation	California
KLA-Tencor (Thailand Branch) Corporation	California
VLSI Standards, Inc.	California
Finle Technologies, Inc.	Texas
INTERNATIONAL SUBSIDIARIES	
KLA-Tencor (Cayman) Limited I	Cayman Islands
KLA-Tencor (Cayman) Limited II	Cayman Islands
KLA-Tencor (Cayman) Limited III	Cayman Islands
KLA-Tencor (Cayman) Limited IV	Cayman Islands
KLA-Tencor (Israel) Corporation	Israel
KLA-Tencor Holding Corporation 1987 Limited	Israel
KLA-Tencor Corporation 1992 Limited	Israel
KLA-Tencor Italy S.R.L.	Italy
KLA-Tencor Japan, Ltd.	Japan
KLA-Tencor Foreign Sales Corporation	Barbados
KLA-Tencor GmbH	Germany
KLA-Tencor France SARL	France
KLA-Tencor Korea, Inc.	Korea
KLA-Tencor Limited	United Kingdom
KLA-Tencor (Malaysia) Sdn Bhd	Malaysia
KLA-Tencor (Singapore) PTE, Ltd.	Singapore
KLA-Tencor (Service) Limited	United Kingdom
Kingdom	
VLSI Standards, KK	Japan
KLA-Tencor International Trading (Shanghai) Co. Ltd.	China
KLA Instruments Switzerland, S.A.	Switzerland
Nanopro GmbH	Germany
Yield Analysis Software Technologies, Ins.	Taiwan
Lee Ta Technologies (BVI), Inc.	British Virgin Islands

EXHIBIT 23.1

Consent of Independent Accountants

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 33-15784, No. 2-71584, No. 2-75314, No. 33-26002, No. 33-42973, No. 33-42982, No. 33-42975, No. 33-55362, No. 33-88662, No. 333-03003, No. 333-22939, No. 333-22941, No. 333-26681, No. 333-32537, No. 333-45271, No. 333-60887, No. 333-60883, No. 333-68423, No. 333-68415, No. 333-85121, No. 333-85123 and No. 333-46598) and in the Prospectus constituting part of the Registration Statement on Form S-3 (No. 333-52393) of KLA-Tencor Corporation of our report dated July 24, 2000 relating to the financial statements and the financial statement schedule, which appear in this Annual Report on Form 10-K.

PRICEWATERHOUSECOOPERS LLP

San Jose, California  
September 27, 2000

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<ARTICLE> 5

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THIS SCHEDULE CONTAINS SUMMARY FINANCIAL INFORMATION EXTRACTED FROM THE CONSOLIDATED STATEMENT OF OPERATIONS, THE CONSOLIDATED BALANCE SHEET AND THE ACCOMPANYING NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS, AND IS QUALIFIED IN ITS ENTIRETY BY REFERENCE TO SUCH FINANCIAL STATEMENTS.

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